Petition

CORRECTED COPY

No. 81-1744

In the Supreme Court of the United States

OCTOBER TERM, 1981

FEDERAL HOME LOAN BANK BOARD, PETITIONER

v.

GULF FEDERAL SAVINGS AND LOAN ASSOCIATION OF JEFFERSON PARISH

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

JOHN M. MILLER
Acting Chief Counsel
Office of the Comptroller of the Currency
Washington, D.C. 20219

MICHAEL BRADFIELD
General Counsel
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

THOMAS A. BROOKS
General Counsel
Federal Deposit Insurance Corporation
Washington, D.C. 20219

JOHN L. OSTBY
General Counsel
National Credit Union Administration
Washington, D.C. 20456

REX E. LEE
Solicitor General

STEPHEN M. SHAPIRO
Deputy Solicitor General

HARRIET S. SHAPIRO
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

THOMAS P. VARTANIAN
General Counsel

HARVEY SIMON
Associate General Counsel

JEFFREY M. WERTHAN
Attorney
Federal Home Loan Bank Board
Washington, D.C. 20552

QUESTION PRESENTED

Whether a federally chartered savings and loan association's consistent and uncorrected practice of overcharging its borrowers is an "unsafe or unsound" practice subject to control by a cease and desist order entered pursuant to 12 U.S.C. 1464(d)(2)(A).

TABLE OF CONTENTS

	Page
Opinions below	2
Jurisdiction	2
Statute involved	2
Statement	3
Reasons for granting the petition	10
Conclusion	19
Appendix A	1a
Appendix B	18a
Appendix C	20a
Appendix D	22a
Appendix E	123a

TABLE OF AUTHORITIES

Cases:

Board of Governors v. *First Lincolnwood Corp.*, 439 U.S. 234	11, 14
Bowman Transportation Inc. v. *Arkansas Best Freight Systems, Inc.*, 419 U.S. 281	17
Citizens to Preserve Overton Park, Inc. v. *Volpe*, 401 U.S. 402	17
Consolo v. *Federal Maritime Commission*, 383 U.S. 607	17
Espinoza v. *Farah Manufacturing Co.*, 414 U.S. 86	14
Fahey v. *Mallonee*, 332 U.S. 245	10
First National Bank of Eden v. *Department of the Treasury*, 568 F.2d 610	14
First National Bank of LaMarque v. *Smith*, 610 F.2d 1258	14
Groos National Bank v. *Comptroller of the Currency*, 573 F.2d 889	14

Cases—Continued

	Page
Independent Bankers Association of America v. *Heimann*, 613 F.2d 1164, cert. denied, 449 U.S. 823	14
Otero Savings & Loan Association v. *Federal Home Loan Bank Board*, 665 F.2d 279	12
Red Lion Broadcasting Co. v. *FCC*, 395 U.S. 367	14

Statutes:

Federal Home Loan Bank Act, 12 U.S.C. 1421 *et seq.*	5, 7
Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028	4
Home Owners' Loan Act of 1933, 12 U.S.C. (& Supp. II) 1461 *et seq.*:	
12 U.S.C. 1464(a)(1)	3
12 U.S.C. 1464(d)(2)(A)	2, 4, 7, 11, 13
12 U.S.C. (Supp. II) 1464(d)(2)(A)	7
12 U.S.C. 1464(d)(3)(A)	4, 16
Pub. L. No. 95-630, 92 Stat. 3651	2
Pub. L. No. 96-37, Section 1(a), 93 Stat. 95 (15 U.S.C. (Supp. IV) 45(a)(2))	16
12 U.S.C. 1724 *et seq.*	3
12 U.S.C. 1786(e)	4, 11
12 U.S.C. 1813(g)	4
12 U.S.C. 1818(b)	4, 11

Miscellaneous:

Comptroller General of the United States, *Federal Supervision of State and National Banks* (1977)	11
K. Davis, *Administrative Law Treatise* (1958)	12
112 Cong. Rec. (1966):	
p. 24984	4
p. 26474	4
Financial Institutions Supervisory and Insurance Act of 1966: Hearings on S. 3158 Before the House Comm. on Banking and Currency, 89th Cong., 2d Sess. (1966)	13-14

Miscellaneous—Continued

Page

G. Hill, *Why 67 Insured Banks Failed—1960 to 1974* (F.D.I.C. 1975) 11

H.R. Rep. No. 96-652 (Pt. 1), 96th Cong., 1st Sess. (1979) 16

Kaufman, *Preventing Bank Failures*, reproduced in Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess., *Compendium on Major Issues in Bank Regulations* (Comm. Print 1975) 11

In the Supreme Court of the United States

OCTOBER TERM, 1981

No.

FEDERAL HOME LOAN BANK BOARD, PETITIONER

v.

GULF FEDERAL SAVINGS AND LOAN ASSOCIATION OF JEFFERSON PARISH

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

The Solicitor General, on behalf of the Federal Home Loan Bank Board,* petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.[1]

---

* This petition also serves as an amicus curiae brief supporting the petition on behalf of the other federal financial institution regulatory agencies: the Board of Governors of the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the National Credit Union Administration. These agencies filed an amicus brief supporting the Federal Home Loan Bank Board in the court of appeals.

[1] The opinion of the court of appeals was rendered by a panel of the United States Court of Appeals for the Fifth Circuit prior to the commencement of operations of the Eleventh Circuit.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-17a) is reported at 651 F.2d 259. The administrative decisions of the Federal Home Loan Bank Board (Apps. D and E, *infra*, 22a-147a) are not reported.

JURISDICTION

The judgment of the court of appeals (App. B, *infra*, 18a-19a) was entered on July 17, 1981. A timely petition for rehearing was denied (App. C, *infra*, 20a-21a) on November 5, 1981. On January 20, 1982, Justice White extended the time for filing a petition for a writ of certiorari to and including March 5, 1982, and on February 24, 1982, he further extended the time to March 19, 1982. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

Section 5(d)(2)(A) of the Home Owners' Loan Act of 1933, as amended, 12 U.S.C. 1464(d)(2)(A), provided in pertinent part: [2]

> If, in the opinion of the Board, an association is violating or has violated, or the Board has reasonable cause to believe that the association is about to violate, a law, rule, regulation, or charter or other condition imposed in writing by the Board * * * or is engaging or has engaged, or the Board has reasonable cause to believe that the association is about to engage, in any unsafe or unsound practice, the Board may issue and serve upon the association a notice of charges in respect thereof. The notice shall * * * fix a time

[2] The provision was amended in 1978 (Pub. L. No. 95-630, 92 Stat. 3651). The amendments are not relevant to the issue presented herein.

and place at which a hearing will be held to determine whether an order to cease and desist therefrom should issue against the association. * * * Unless the association shall appear at the hearing by a duly authorized representative, it shall be deemed to have consented to the issuance of the cease-and-desist order. In the event of such consent, or if upon the record made at any such hearing the Board shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the Board may issue and serve upon the association an order to cease and desist from any such violation or practice.

STATEMENT

1. The Federal Home Loan Bank Board (Board or Bank Board) is authorized under the Home Owners Loan Act "to provide for the organization, incorporation, examination, operation, and regulation" of federal savings and loan associations, and to issue charters for such institutions, "giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States." 12 U.S.C. 1464(a)(1).[3]

In order to provide the Bank Board and other federal financial institution regulatory agencies[4] with

---

[3] The Bank Board also is the corporate head of the Federal Savings and Loan Insurance Corporation (FSLIC), which is responsible for insuring the accounts of federally chartered savings and loan associations, member state chartered savings and loan associations, and federal mutual savings banks (12 U.S.C. 1724 *et seq.*).

[4] These agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and (since 1970) the National Credit Union Administration.

flexible and effective methods for supervising the practices of regulated institutions, Congress enacted the Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028, which broadly authorizes each agency to issue cease and desist orders whenever the agency determines that the institution is engaging in, has engaged in, or is about to engage in "any unsafe or unsound practice" or has or is about to violate, *inter alia*, a law, rule, or regulation. The Bank Board's cease and desist authority is prescribed in 12 U.S.C. 1464(d)(2)(A).[5] If an unsafe or unsound practice "is likely to cause insolvency * * * or substantial dissipation of assets or earnings of the association, or is likely to otherwise seriously prejudice the interests of its savings account holders" in the absence of prompt action, the Board may issue a temporary cease and desist order before completion of administrative proceedings (12 U.S.C. 1464(d)(3)(A)).

The statute does not attempt to specify what constitutes "any unsafe or unsound practice," leaving construction and application of that broad generic standard to the financial institution regulatory agencies. The legislative history (112 Cong. Rec. 26474, 24984 (1966)), which quotes a detailed memorandum of Bank Chairman John Horne, demonstrates the breadth of the supervisory power that Congress intended to bestow:

---

[5] The parallel provision for the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, may be found at 12 U.S.C. 1818(b) (see 12 U.S.C. 1813(q)). When the National Credit Union Administration was created, it was given the same authority (12 U.S.C. 1786(e)).

> Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

2. Respondent is a federally chartered savings and loan association subject to the regulatory authority of the Bank Board (App. A, *infra*, 1a). On March 9, 1977, the Bank Board served a notice of charges on respondent asserting that it had engaged in unsafe or unsound practices by dishonoring the interest calculation clauses in 444 of its mortgage loan contracts, and thereby had credited to its account interest to which it was not entitled (App. D, *infra*, 22a).[6] Respondent denied the charges and asserted that, even if true, the charges would not support the issuance of a cease and desist order.

The evidence adduced at the hearing before the administrative law judge (ALJ) showed that respondent had consistently calculated the interest charges on its mortgage loans on the basis of a 365/360 day interest table, which meant that interest charges were calculated as though the year contained 360 days, but were charged for the full 365 days. However, mortgage loan contracts drawn by respondent between July 3, 1969, and February 14, 1973, contained the statement that "all interest shall be calculated monthly on the

---

[6] The notice also asserted that by dishonoring the interest calculation clause, respondent had violated provisions of the Federal Home Loan Bank Act (12 U.S.C. 1421 *et seq.*) (Bank Act) and federal common law, which also warranted the issuance of a cease and desist order.

basis of a 365 day calendar year and charged for each day of the month" (App. D, *infra*, 25a, 38a n.5).[7] As a result of using the higher interest from the 360/365 day tables on those mortgages, by June 1978 respondent had credited to its account more than $90,000 of interest to which it was not entitled under the terms of its contracts (App. E, *infra*, 125a).[8] Respondent claimed that no overcharges had occurred because the contract terms were ambiguous, that the custom of the community indicated that the 365/360 day interest rate tables were permissible (App. D, *infra*, 27a), and, in any event, that its activities were not "unsafe or unsound" because they did not affect respondent's stability (*id.* at 50a).

On September 20, 1977, the ALJ rendered a recommended decision and proposed order requiring respondent to cease and desist from the challenged practices and to refund the excess interest (App. D, *infra*, 23a-24a). After a full de novo review, the Board adopted the record certified by the ALJ, and accepted his conclusions. However, the Board issued its own opinions: an Initial Decision on liability (App. D, *infra*, 22a-122a), and, after further development of the record, a Final Decision on remedy (App. E, *infra*, 123a-147a).

The Board concluded first that the loan contract provision defining the method by which interest was

---

[7] Although it originally appeared that 444 loan contracts contained this clause, it later developed that only 413 did (App. E, *infra*, 126a n.6).

[8] Respondent reduced the interest rate by one percent on the loan of the one borrower who became aware that he had been overcharged, so that the net loss to this particular borrower amounted to $9.05. This borrower later withdrew all his deposits. Subsequently, 24 borrowers received similar interest rate modifications (App. E, *infra*, 126a n.6).

to be calculated was not ambiguous (App. D, *infra*, 33a-37a), and that "there can be little doubt that [respondent's] practice is in breach of that provision" (*id.* at 37a). It then determined that it was authorized to issue a cease and desist order on three separate grounds under Section 5(d)(2)(A) of the Home Owners Loan Act, as amended, 12 U.S.C. (Supp. II) 1464(d)(2)(A), because the practice constituted: 1) an unsafe or unsound practice; 2) a violation of the Bank Act (12 U.S.C. 1421 *et seq.*); and 3) a series of continuing breaches of contract in violation of federal common law (App. D, *infra*, 47a-122a).

In its Initial Decision, the Board noted that the statutory authority to control "unsafe or unsound" practices was designed to furnish "a flexible supervisory tool which would provide a substitute for a multitude of detailed regulations" (App. D, *infra*, 57a). In light of the Horne memorandum (see pages 4-5, *supra*), the statutory phrase embraces "any practice which is 'contrary to generally accepted standards of prudent operation' and which 'if continued,' could have the 'possible consequence' of 'abnormal risk or loss or damage' to a Federal savings institution, its shareholders or the FSLIC" (*id.* at 60a). The Board found that respondent's systematic pattern of overcharging customers gave rise to an "abnormal risk"[9] within the meaning of that broad standard.

[9] The Board concluded that a risk is "abnormal" not only when it is one "of great degree" that has a significant impact on the institution's financial condition, but also when it is "'unlike' the kinds of risks, losses or damage which are inherent in and reasonably expected to occur from time to time in the operation of a financial institution" (App. D, *infra*, 72a-75a). Without deciding whether respondent's practice was "abnormal" in degree, the Board concluded it was "abnormal" because "it is not the kind of risk that a prudent lender normally would take" (*id.* at 74a).

Moreover, respondent's systematic violation of its contractual obligations was imprudent, the Board found, and posed an abnormal risk to the association. This was true both because of the potential liability to borrowers for continuing overcharges and because the damage to respondent's reputation caused by such practices could seriously jeopardize its ability to retain and attract customers (App. D, *infra*, 75a-81a, 90a).

The Board also concluded in its Initial Decision that its cease and desist authority permits it to require corrective action, such as restitution of interest improperly collected, but that the record was insufficient to permit a determination of the proper relief (App. D, *infra*, 82a-93a). After further briefing on alternative forms of relief and determination of the precise amount of overcharges, the Board found that, although respondent had used 365/365 day tables in calculating the combined monthly principal and interest charges on the disputed loans, as required by its mortgage contracts, respondent had used 365/360 day tables to enter excess interest charges on its own books.[10] The Board therefore required respondent to

---

[10] The Board found (App. E, *infra*, 126a-127a & n.7) that "excessive interest was charged to all of the Borrowers' accounts." It explained its finding as follows:

> [B]ecause of [respondent's] practice of charging interest on its books on a 365/360 day basis, [respondent] used too much of each payment to pay interest and used too little of each payment to reduce principal.

The economic result was that, on respondent's books, every borrower had an understated equity position in his house, and therefore lost money when his mortgage obligation was assumed or paid off. In addition, the error extended the amortization period for the loans. For example, on a 25 year loan at 9%, the stated monthly payments would repay the principal in full in exactly 25 years if the 365/365 day formula

make the necessary bookkeeping adjustments for all the affected borrowers and to repay those whose mortgages had been paid off or assumed (App. E, *infra*, 145a-146a).[11]

Although the Board agreed that respondent could obtain waivers or consents to the reformation of the loans from the affected borrowers instead of making restitution, it rejected the 103 "Acts of Correction" submitted by respondent on the ground that they did not adequately disclose to borrowers the significance of their waivers (App. E, *infra*, 141a-142a). The Board accordingly issued a cease and desist order permitting respondent to solicit the execution of adequate agreements for four more months (until October 16, 1978), but requiring it to make restitution to all affected borrowers who had not executed such agreements by that date, either by correcting its books or by making lump sum payments (*id.* at 144a-147a).

3. On respondent's petition for review of the cease and desist order, the court of appeals reversed. The court rejected the Board's interpretation of the scope of its authority to control "unsafe or unsound" banking practices. Although it agreed that the Horne memorandum definition is authoritative, it concluded that respondent's challenged practices involve risks that "bear only the most remote relationship to [respondent's] financial integrity and the government's insurance risk. They are qualitatively different from

---

were used, but would take approximately a year longer using the 365/360 day formula (C.A.R. at 14).

[11] The total amount of repayment required as of December 31, 1977, was estimated to be $29,335 (App. E, *infra*, 128a). The Board rejected the General Counsel's suggestion that respondent be required to pay the borrowers interest on the sums improperly withheld (*id.* at 131a-132a).

the risks Chairman Horne called to the attention of the 89th Congress" (App. A, *infra*, 10a).[12] In sum, the court concluded that "[t]he 'unsafe or unsound practice' provision * * * refers only to practices that threaten the financial integrity of the association" (*id.* at 17a).[13]

REASONS FOR GRANTING THE PETITION

1. As this Court has recognized, "[b]anking is one of the longest regulated and most closely supervised of public callings." *Fahey* v. *Mallonee*, 332 U.S. 245, 250 (1947).[14] The ability of the federal banking

---

[12] The court "fail[ed] to see how" requiring respondent to repay the excess interest could protect it from the risk of liability for overcharges, and rejected the injury to reputation rationale as involving excessive intrusion by the Bank Board into the association's affairs (App. A, *infra*, 11a).

[13] The court also concluded that the cease and desist order was not properly grounded in a finding that there had been a violation of law (App. A, *infra*, 11a-17a). In reaching that conclusion, the court found that the loan contracts were ambiguous on their face, and that respondent's resolution of the ambiguity was consistent with the parties' intent (*id.* at 16a-17a). In fact, however, the ambiguity on which the court relied did not exist. The Board found that the loan payments were calculated using the 365/365 day tables as the contract terms provided (App. E, *infra*, 126a-127a). The Board's decision thus rested not on an ambiguous contract, but on a widespread failure to adhere to the unambiguous commitment that respondent made to its borrowers. While the court's conclusion on this point is clearly erroneous, we do not believe that the error is of broad enough significance to merit review by this Court.

[14] As discussed in the Federal Home Loan Bank Board's brief amicus curiae in *Fidelity Federal Savings and Loan Association, Inc.* v. *de La Cuesta*, No. 81-750, Congress intended the Bank Board to have "plenary authority * * * to regulate virtually every aspect of the federal savings and loan industry." *Id.* at 16. We are serving a copy of the

agencies to issue cease and desist orders to restrain practices that they find, in the exercise of their expert judgment, to be unsafe or unsound is an essential ingredient in the nation's system for protection of federally insured financial institutions.[15] The decision of the court of appeals represents a serious threat to the effective use by the bank regulatory agencies of their broad statutory authority to issue such orders.[16] For each of these agencies, that authority rests on a determination that the regulated institution has committed or its about to commit an "unsafe or unsound" practice (12 U.S.C. 1464(d)(2)(A); 12 U.S.C. 1818(b); 12 U.S.C. 1786(e)). The court of appeals' failure to defer to the bank regulatory agency's interpretation of its own statutory mandate (see *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248 (1978)), and the court's imposition of artificial restrictions on the broad statutory language (*id.* at 243), seriously cur-

---

government's brief amicus curiae on counsel for respondent in this case.

[15] According to a 1977 study by the General Accounting Office, the primary cause of 30 of the 42 bank failures that occurred between 1971 and 1976 was improper, unethical and dishonest practices of bank management. See Comptroller General of the United States, *Federal Supervision of State and National Banks* 9-3 (1977). See also Kaufman, *Preventing Bank Failures*, reproduced in Senate Comm. on Banking, Housing, and Urban Affairs, 94th Cong., 1st Sess., *Compendium of Major Issues in Bank Regulation* 769, 773-776 (Comm. Print 1975); G. Hill, *Why 67 Insured Banks Failed—1960 to 1974*, at 1-3 (F.D.I.C. 1975).

[16] The views expressed in this petition are shared by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the National Credit Union Administration, which fully support the Bank Board's petition in this case.

tail the ability of the agency to protect thrift institutions against improper practices that expose them to financial risk and damage their business reputation.

The restrictive ruling of the court of appeals also will have an adverse effect on the day-to-day supervision exercised by the bank regulatory authorities. The agencies' supervisory powers are currently exercised almost entirely by conciliation and agreement. And in those few cases in which informal methods fail, administrative proceedings are almost always settled by consent. This system of supervisory regulation, which has been characterized as "one of the most successful, if not the most successful" (K. Davis, *Administrative Law Treatise* § 4.04 (1958)), has been based on the regulated institutions' recognition of the very broad scope of the cease and desist authority of the agencies. The decision below, adopting a restrictive view of that authority, encourages litigation and thus threatens delays that will impair this effective method of protecting the public.[17] The decision of the court of appeals is a potent source of disruption because it makes crucial the issue of the institution's "financial integrity"—an undefined term that can be expected to become the battleground on which both informal supervision and cease and desist orders will be resisted.[18]

2. This destabilizing effect will result, not from any necessity to correct over-reaching by the Bank Board, but from t' court of appeals' fundamental

---

[17] In light of the severe economic difficulties currently facing the savings and loan industry, it is particularly important that the Bank Board's prophylactic powers retain their effectiveness.

[18] This process already has begun to occur. See *Otero Savings & Loan Association* v. *Federal Home Loan Bank Board*, 665 F.2d 279, 291-292 (10th Cir. 1981) (concurring opinion).

misconception of the Board's authority. The statutory language, which is the starting point for analysis, prescribes the Bank Board's power in broad generic terms. The Bank Board's power to issue cease and desist orders extends, without limitation, to "any unsafe or unsound practice." 12 U.S.C. 1464 (d)(2)(A).[19] Moreover, the Horne memorandum, which the court of appeals properly accepted as an authoritative expression of Congress' intent (App. A, *infra*, 9a), clearly exlains that:

> The concept of "unsafe or unsound practices" is one of general application which touches upon the entire field of the operations of a financial institution. For this reason, it would be virtually impossible to attempt to catalog within a single all-inclusive or rigid definition the broad spectrum of activities which are embraced by the term. The formulation of such a definition would probably operate to exclude those practices not set out in the definition, even though they might be highly injurious to an institution under a given set of facts or circumstances or a scheme developed by unscrupulous operators to avoid the reach of the law.

Financial Institutions Supervisory and Insurance Act of 1966: Hearings on S. 3158 Before the House

---

[19] Congress could not have prescribed the Bank Board's prophylactic powers in more expansive terms. The statute is worded in the disjunctive, and reaches "any" unsafe or unsound banking practice that has occurred or is threatened. A course of action is "unsafe" if it "expos[es] to danger" or is "unreliable" (*Webster's Third New International Dictionary* 2509 (1976)). A course of action is "unsound" if it is "not based on proven practice" or "established procedure" (*id.* at 2511). The literal terms of the statute thus include any practice that exposes a thrift institution to danger, as well as any practice that deviates from established or proven banking procedures. Cf. App. D, *infra*, 72a-75a.

Comm. on Banking and Currency, 89th Cong., 2d Sess. 49 (1966) (memorandum supplied by John E. Horne, Chairman, Federal Home Loan Bank Board).

The court of appeals' assertion that the examples given in the Horne memorandum exhaust the coverage of the broad generic language used by Congress represents precisely the sort of rigidity that Chairman Horne himself emphasized should be avoided. Indeed, earlier decisions of the Fifth Circuit have recognized that the statutory ban on "unsafe or unsound practices" is a comprehensive one, and that "one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies" *Groos National Bank* v. *Comptroller of the Currency*, 573 F.2d 889, 897 (1978); *First National Bank of LaMarque* v. *Smith*, 610 F.2d 1258, 1265 (1980) (quoting *Groos*). The decisions of other courts of appeals are to the same effect: *Independent Bankers Association of America* v. *Heimann*, 613 F.2d 1164, 1168-1169 (D.C. Cir.), cert. denied, 449 U.S. 823 (1980); *First National Bank of Eden* v. *Department of Treasury*, 568 F.2d 610 (8th Cir. 1978). In these circumstances, it is particularly appropriate for the courts to defer to the agency's construction of its own statutory mandate. See, *e.g.*, *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 251 (1978); *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969); *Espinoza* v. *Farah Manufacturing Co.*, 414 U.S. 86, 94-95 (1973).

3. The court below explicitly refused to accord the Board this deference (App. A, *infra*, 8a). The court of appeals apparently intended, by its emphasis on the necessity for an effect on the institution's "fi-

nancial integrity," to require something more than a showing of conduct "contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds" (Horne memorandum, *supra*, page 5). Moreover, the court's lack of clarity on this subject [20] contributes to the destabilizing effect of its decision, because it encourages litigation by creating doubts concerning the scope of the Board's supervisory powers.[21]

If the court meant that only those imprudent operations that pose a risk of immediate substantial loss to the institutions are subject to a cease and desist order, its decision is plainly inconsistent with the statutory scheme, which gives the Board power to prevent activities that, if continued, would cause sig-

---

[20] The court's emphasis on the need for "a reasonably direct effect on an association's financial soundness" (App. A, *infra*, 9a), and its view that restitution would cause respondent only "a minor financial loss" (*id.* at 10a), suggest that the court believed that only unsound practices threatening the association's continued financial existence are subject to cease and desist orders. On the other hand, its modification, on request for rehearing, of the reference to the "congressional concept" of acting " 'to prevent financial collapse' " (App. C, *infra*, 20a), suggests that the court agreed with the position of the Board and the other regulatory agencies in their briefs in support of the petition for rehearing that a lesser risk was sufficient. It is still totally unclear what degree of harm the court would deem sufficient.

[21] For example, the Board may, under the court of appeal's decision, be unable to protect borrowers or savers from dishonest practices that inure to a financial institution's short term benefit but threaten adverse effects in the long term.

nificant harm. The Home Owners Loan Act provides special procedures for situations involving a risk of "insolvency * * * or substantial dissipation of assets or earnings * * *." In such cases, in contrast to the usual cease and desist order proceeding, the Board may issue a *temporary* restraining order pending the completion of the administrative hearings (12 U.S.C. 1464(d)(3)(A)). This special provision shows that when Congress intended the Board's corrective authority to extend only to practices threatening insolvency or the substantial dissipation of assets, it said so directly.

A "substantial loss" limitation is also plainly inconsistent with congressional action in abrogating Federal Trade Commission jurisdiction over the unfair or deceptive practices of savings and loan institutions in order to eliminate "duplicative regulations" of such institutions by both the Commission and the Board. Pub. L. No. 96-37, Section 1(a), 93 Stat. 95 (15 U.S.C. (Supp. IV) 45(a)(2)). The House Committee Report relies on a summary of the Board's action in the instant case in concluding that "the Bank Board has the necessary regulatory tools to protect consumers from unfair or deceptive acts or practices by savings and loan associations" (H.R. Rep. No. 96-265 (Pt. 1), 96th Cong., 1st Sess. 2-3 (1979). Thus, Congress plainly believed that the existing cease and desist authority reached unsafe and unsound practices that affect a financial institution indirectly by injuring its customers and its business reputation.

If, on the other hand, the court of appeals meant that there had been no showing of *any* abnormal risk to the financial institution, but only to its borrowers, the court incorrectly rejected the express findings of

the Board on a matter peculiarly within its expertise, even though these findings clearly are supported by substantial evidence.[22] Thus, the Board's finding that respondent's misrepresentations to several hundred customers posed an abnormal risk of harm resulting from a loss of public confidence is supported by the express admission of respondent's president, who stated that publicity concerning respondent's actions " 'would do some business harm to us far beyond any harm that could come from us having to pay this interest back; and this is the thing that we've been very apprehensive about from the very beginning, and it's a very real danger' " (App. D, *infra*, 75a n.35, 73a n.31).[23]

Accordingly, record evidence confirmed the commonsense inference that the expert agency was entitled to draw: public reaction to misrepresentations practiced on a broad scale can be highly injurious to the economic welfare of a financial institution. The Board was not, as the court of appeals believed, simply attempting to enforce its own views of "the public's standard of fairness" (App. A, *infra*, 11a). This is

---

[22] In the absence of any analysis by the court of appeals indicating that the Bank Board's findings were unsupported by substantial evidence, it was error for the court to reverse the Bank Board's decision, *Consolo* v. *Federal Maritime Commission*, 383 U.S. 607, 620 (1966), or to substitute its views for those of the agency, *Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. 402, 416 (1971); accord, *Bowman Transportation, Inc.* v. *Arkansas Best Freight Systems, Inc.*, 419 U.S. 281, 290 (1974).

[23] The validity of these concerns is further underscored by the fact that the one borrower who did discover the discrepancy withdrew his savings from respondent even though his loan agreement was amended in light of the overcharge (see note 8, *supra*).

not a case involving an isolated error, or a single dishonest practice; it is instead a case in which misrepresentation was practiced on a broad scale for several years, and involved hundreds of respondent's customers. The court of appeals also was in error in suggesting that a cease and desist order would cause more harm than it would prevent.[24] The purpose of the order is to straighten out the affairs of respondent before they disintegrate even further, and to restrain management from engaging in similar practices that could compound respondent's financial difficulties and further impair its business reputation.

---

[24] The court concluded that it was the Board's restitution remedy, not respondent's overcharges, that threatened respondent's finances, and "[w]e fail to see how the Board can safeguard [respondent's] finances by making definite and immediate an injury which is, at worst, contingent and remote" (App. A, *infra*, 11a). But the Board's restitution remedy was part of an effort to terminate respondent's *continuing* collection of excess interest. As the Board noted, respondent "seeks not only to avoid refunding interest collected in excess of that earned under the terms of the note but also to continue the wrongful interest computation in the future, arguing that the revelation of its conduct necessary to cure the mischarging could severely harm its reputation" (App. D, *infra*, 76a). The Board's efforts to terminate this continuing accrual of liability by respondent and to require the immediate refund of interest payments already improperly collected would safeguard respondent's financial interests by preventing a larger ultimate liability to victimized borrowers and by putting an end to deception harmful to its reputation.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

REX E. LEE
Solicitor General

STEPHEN M. SHAPIRO
Deputy Solicitor General

HARRIET S. SHAPIRO
Assistant to the Solicitor General

THOMAS P. VARTANIAN
General Counsel

HARVEY SIMON
Associate General Counsel

JEFFREY M. WERTHAN
Attorney
Federal Home Loan Bank Board

JOHN M. MILLER
Acting Chief Counsel
Office of the Comptroller of the Currency

MICHAEL BRADFIELD
General Counsel
Board of Governors of the Federal Reserve System

THOMAS A. BROOKS
General Counsel
Federal Deposit Insurance Corporation

JOHN L. OSTBY
General Counsel
National Credit Union Administration

MARCH 1982

Appendix

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 78-2549

GULF FEDERAL SAVINGS AND LOAN ASSOCIATION OF JEFFERSON PARISH, PETITIONER

v.

FEDERAL HOME LOAN BANK BOARD, RESPONDENT

July 15, 1981

Petition for Review of an Order of the Federal Home Loan Bank Board

Before CHARLES CLARK, TJOFLAT and GARZA, Circuit Judges.

CHARLES CLARK, Circuit Judge:

Gulf Federal Savings and Loan Association petitions for review of an order by the Federal Home Loan Bank Board, claiming that the Board used its cease and desist authority improperly, in an attempt to enter the consumer protection field. Because we find no statutory authority for the cease and desist order, we grant the petition for review and reverse the Board's decision.

I.

Gulf Federal was chartered as a federal savings and loan association on May 20, 1965. The first meeting of the Board of Directors was held on June 11, 1965. At that meeting, the Board of Directors re-

solved that "[i]nterest shall be calculated by use of 360 day interest tables with interest charged for each day in the month." This method of calculating interest is known as the "banker's rule," and is in common use in the New Orleans area. It results in higher interest payments to the lender because the interest rate is computed as though there were 360 days in the year but is charged to borrowers for 365 days. Actual interest paid is thus 365/360 of the nominal interest rate, or 5/360 more than the rate charged under a day-for-day, or 365/365, interest calculation. On a loan with a nominal interest rate of 8 percent, the 365/360 method results in an actual interest rate of approximately 8.11 percent. Nevertheless, all parties agree that the 365/360 method is a legitimate means of calculating interest, and the Bank Board does not challenge Gulf Federal's right to choose to calculate interest in this way.

From June 11, 1965, to June 10, 1969, all Gulf Federal loan agreements contained the following provision:

> All interest is to be calculated monthly by use of the three hundred and sixty day interest tables, and charged for each day of the month, on any balance of the principal sum remaining due and unpaid.

This provision established the 365/360 method as the means for calculating interest in these contracts. On June 10, 1969, however, the Board of Directors unanimously adopted a motion "that the method of calculating interest on the 360 day factor be changed to the 365 day basis." Gulf Federal loan officers implemented this change immediately by deleting language from the printed loan agreement forms and substitut-

ing typed language in its place. The new language stated, "[a]ll interest is to be calculated monthly on the basis of a 365 day calendar year and charged for each day in the month."[1] Gulf Federal has argued before the Board and this court that this provision is ambiguous. The Board rejected these arguments. So do we. It plainly calls for use of the 365/365 method. In actual practice the provision was ignored and interest calculations continued to be made on the 365/360 banker's rule basis.

On October 14, 1969, the Board of Directors passed a motion that amended the June 10, 1969, motion to state that "the method of calculating interest on loans [is] to be done by the 360 day factor on a calendar year basis." This resolution effectively repealed the June 10 resolution and reinstated the 365/360 method of calculating interest. Nevertheless, until February 14, 1973, Gulf Federal loan officers continued using loan agreement forms which contained a provision calling for use of the 365/365 method, and for more than three years provisions in the loan contract forms used by Gulf Federal were at odds with the prevailing resolution by its Board of Directors.

The various Board of Directors resolutions and loan agreement provisions apparently had no effect on the day-to-day course of Gulf Federal's affairs. Gulf Federal never calculated interest on its loans

---

[1] Some of the typewritten provisions reflect apparently inadvertent deviations from the language of the new provision. Thus, in one loan agreement the word "year" was omitted from the phrase "calendar year." The Bank Board also suggests that in one case a loan officer crossed out the old language but failed to type in the new provision. In general, however, it appears that these variations resulted from confusion, and that Gulf Federal attempted to insert the new provision on a uniform basis.

under the 365/365 method, regardless of the prevailing resolution of the Board of Directors or any agreement provision to the contrary. From June 10, 1969, to February 14, 1973, as at all other times, the 365/360 method was used to calculate the amount of interest paid.

Each of the loan agreements entered into during the June 10, 1969, to February 14, 1973, period prominently stated (1) the principal sum of the loan, expressed in dollars, (2) the interest rate to be charged on the loan, expressed as a percentage of principal, and (3) an exact monthly payment, expressed in dollars and calculated according to the 365/360 method. Gulf Federal received monthly payments from each of its borrowers in the amounts specified on the face of their respective loan agreements. All of these amounts were determined on the 365/360 basis.

Of the more than 400 Gulf Federal borrowers whose contracts made during this period contained one of the provisions calling for interest to be calculated on a basis inconsistent with the monthly payment shown and charged, only one noticed the discrepancy. No borrower threatened to sue Gulf Federal, and most either signed or were willing to sign agreements amending the original contract and approving use of the 365/360 method.[2] Nevertheless, upon learning of the situation, the Bank Board instituted cease and desist proceedings against Gulf Federal. After a hearing before an administrative law judge, the full Board issued opinions and a cease and

---

[2] Gulf Federal executed such agreements with some 40 percent of its borrowers. The effort to correct the loan agreements ended, however, when the Board began proceedings against the association.

desist order directing Gulf Federal to calculate interest under the 365/365 method described in its loan agreements, and to reinmburse borrowers for the difference in all payments made under the 365/360 method. That order is the subject of today's appeal.

II.

Gulf Federal asserts that the cease and desist order is unrelated to the Board's traditional sphere of activity. According to Gulf Federal, the Board's function is to assure the financial stability of savings and loan associations, not to protect consumers from practices considered by the Board to be unfair. The Board responds that it has "cradle to grave" authority in regulating federal savings and loan associations, and that the order is a proper exercise of its statutory obligation.

The Board was created by the Federal Home Loan Bank Act of 1932, 12 U.S.C. § 1437(a)(1957), to establish and supervise a national system of federal home loan banks, including federal savings and loan associations. A major duty of the Board is to protect the government's interest as an insurer of deposits in federally chartered savings and loan associations. Thus, the Board is empowered to expel an association from the federal savings and loan system, and to cancel its federal insurance, when the association is insolvent, is imprudently managed, or otherwise threatens to implicate the government's insurance liability. *See id.*, § 1426(i). The Home Owners' Loan Act of 1933 (HOLA), *as amended*, 12 U.S.C. § 1461 *et seq.*, (1980), authorized the Board to issue and enforce regulations governing the management of federal savings and loan associations. See 12 U.S.C. § 1464(c)(1). By use of these powers, the Board

was to guarantee the existence of a national system of stable home financing institutions.

The Board's authority to issue cease and desist orders was added to the HOLA by the Financial Institutions Supervisory Act of 1966, Pub.L.No. 89-695, 80 Stat. 1028. The purpose of the amendment was to enhance the Board's ability to promote financial stability among federally chartered savings and loan institutions. *See generally* Note, The Financial Institutions Supervisory Act of 1966, 8 B.C.Ind. & Com.L.Rev. 599, 600-06 (1967). Prior to 1966, the Board's only sanctions against recalcitrant savings and loans were its section 1426(i) power to expel an association from the federal savings and loan program, and its authority to take the association into federal custody. *Id.* at 603; S.Rep.No. 1482, 89th Cong., 2d Sess., [1966] U.S.Code Cong. & Ad.News 3532, 3527. These draconian measures, while justified in cases of egregious mismanagement, were considered too harsh to be effective against most savings and loan mismanagement. *See* S.Rep.No. 1482, *supra*, at 3536. Cease and desist authority was added as an intermediate sanction, to permit the Board to correct imprudent management without casting out the offending institution. *Id.* at 3537-38; *see also* ABA Comm. on Savings and Loan Associations, Handbook of Savings and Loan Law 58 (1973); 112 Cong.Rec. 2483-84 (1966) (remarks of Rep. Patman).

The Board's cease and desist authority is now codified at 12 U.S.C. section 1464(d)(2)(A). Under this section, the Board may issue cease and desist orders whenever it determines that an association is engaging "in an unsafe or unsound practice in conducting the business of such association, or is vio-

lating or has violated . . . a law, rule, or regulation." [3] The Board found that its order against Gulf Federal was authorized on both grounds. Neither ground, however, has enjoyed authoritative judicial atten-

---

[3] The full text of section 1464(d)(2)(A) is as follows:

> If, in the opinion of the Board, any association or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such association is engaging or has engaged, or the Board has reasonable cause to believe that the association or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such association is about to engage, in an unsafe or unsound practice in conducting the business of such association, or is violating or has violated or the Board has reasonable cause to believe that the association or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such association is about to violate, a law, rule, or regulation or charter, or any condition imposed in writing by the Board in connection with the granting of any application or other request by the association or any written agreement entered into with the Board, the Board may issue and serve upon the association or such director, officer, employee, agent, or other person a notice of charges in respect thereof. The notice shall contain a statement of the facts constituting the alleged violation or violations or the unsafe or unsound practice or practices, and shall fix a time and place at which a hearing will be held to determine whether an order to cease and desist therefrom should issue against the association or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such association. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after service of such notice unless an earlier or a later date is set by the Board at the request of any party so served. Unless the party or parties so served shall appear at the hearing by a duly authorized representative, they shall be deemed to have consented to the issuance of the cease-and-desist

tion. Thus, we must define the boundaries of the Board's cease and desist authority. Defining the limits of such powers requires judicial, not administrative, expertise. For this reason, the Board's call for deference to agency expertise is misplaced.

III.

The Board found that Gulf Federal's practice "of entering into contracts and, thereafter, breaching them" was an "unsafe or unsound" practice within the meaning of section 1464(d)(2)(A). Even if the Board's premise is correct, the legislative history of the section belies its conclusion, and we reverse this part of the Board's holding.

The "unsafe or unsound practice" provision was the subject of lively congressional concern at the time section 1464(d)(2)(A) was enacted. Several congressmen expressed the view that the "unsafe or unsound practice" formula was too broad and delegated unlimited authority to the Board. *See, e.g.*, 112 Cong. Rec. 25008 (1966) (remarks of Rep. Holifield). The

---

order. In the event of such consent, or if upon the record made at any such hearing, the Board shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the Board may issue and serve upon the association or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such association an order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory or otherwise, require the association or its directors, officers, employees, agents, and other persons participating in the conduct of the affairs of such association to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

Senate report on the bill noted that the committee had tried to balance the Board's need for flexibility in enforcement against the public's desire to be free of undue federal interference. *See.* S.Rep.No. 1482, *supra*, at 3534-35. Representative Patman, the committee chairman and sponsor of the House bill, recognized these fears and admitted that the House committee had been concerned over possible agency abuse of the "unsafe or unsound" provision. 112 Cong.Rec. 24984 (1966) (remarks of Rep. Patman). He nevertheless assured his fellow legislators that "[w]e of the committee are of the opinion that these terms are sufficiently exact and do not involve an overly broad delegation of power to administrative agencies." *Id.*

The breadth of the "unsafe or unsound practice" formula is restricted by its limitation to practices with a reasonably direct effect on an association's financial soundness. As Representative Patman pointed out during the House debate,

> [o]f course, it should be clear to all that the cease-and-desist powers and management removal powers are aimed specifically at actions impairing the safety or soundness of our insured financial institutions. These new flexible tools relate strictly to the insurance risk and to assure [*sic*] the public sound banking facilities.

112 Cong.Rec. 24984. The authoritative definition of an unsafe or unsound practice, adopted in both Houses, was a memorandum submitted by John Horne, then chairman of the Bank Board. *See* 112 Cong.Rec. 24984 (1966) (remarks of Rep. Patman) (Horne memorandum authoritative in House); *id.* at 26474 (remarks of Sen. Robertson) (Horne memo-

randum included in record in Senate). Chairman Horne defined the provision in the following way:

> Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

112 Cong.Rec. 26474 (1966). Chairman Horne listed several practices that fell within his definition. The examples included such management defalcations as paying excessive dividends, disregarding a borrower's ability to repay, careless control of expenses, excessive advertising, and inadequate liquidity. *Id.*

The Board found that Gulf Federal's use of the inconsistent contract terms was an unsafe or unsound practice because it threatened "abnormal risk or loss or damage" to the association. However, the only risks the Board has identified are Gulf Federal's potential liability to repay over-charged interest, and an undifferentiated "loss of public confidence" in the bona fides of Gulf Federal's operations. Such potential "risks" bear only the most remote relationship to Gulf Federal's financial integrity and the government's insurance risk. They are qualitatively different from the risks Chairman Horne called to the attention of the 89th Congress. While the potential liability for repayment of the difference in interest charges could lead to a minor financial loss for Gulf Federal,[4] the Board's order would consummate this

[4] The estimated "overcharges" total approximately $80,000. In 1979, Gulf Federal had assets of approximately $75 million.

"risk" immediately by forcing Gulf Federal to repay the interest forthwith, whether or not it is owed. We fail to see how the Board can safeguard Gulf Federal's finances by making definite and immediate an injury which is, at worst, contingent and remote.

Approving intervention under the Board's "loss of public confidence" rationale would result in open-ended supervision. The loss of confidence identified by the Board is unlike the loss of confidence which engendered the bank failures of the 1930's. The Board's rationale would permit it to decide, not that the public has lost confidence in Gulf Federal's financial soundness, but that the public may lose confidence in the fairness of the association's contracts with its customers. If the Board can act to enforce the public's standard of fairness in interpreting contracts, the Board becomes the monitor of every activity of the association in its role of proctor for public opinion. This departs entirely from the congressional concept of acting to prevent financial collapse. We decline to adopt the Board's construction of section 1464(d)(2)(A). We limit the "unsafe or unsound practice" provision to an association's financial condition. It does not authorize the Board's cease and desist order against Gulf Federal.

IV.

Section 1464(d)(2)(A) also permits the Board to issue cease and desist orders when a savings and loan association "is violating or has violated . . . a law." Neither the statute nor the legislative history explain which laws, when violated, give rise to the Board's cease and desist power. The Board, however, has suggested several potential "laws" within the meaning of section 1464(d)(2)(A). Because we find

that none of the laws suggested by the Board were violated, we hold that the cease and desist power may not be based on this provision.[5]

A. *The Bank Act*

The Board's first argument is that Gulf Federal has violated the Bank Act, *as amended*, 12 U.S.C. § 1421 *et seq.* (1957). Section 1424(a) of the Act provides that

> [n]o institution shall be eligible to become a member of [the federal savings and loan system] if, in the judgment of the board its financial condition is such that advances may not safely be made to such institution, or the character of its management or its home-financing policy is inconsistent with sound and economical home financing.

In the Board's view, Gulf Federal's policy of calculating interest under the 365/360 method is inconsistent with "sound and economical home financing" and thus violates section 1424(a).

We disagree with the Board for two reasons. First, section 1424(a) provides the criteria for membership in the federal savings and loan system. It does not establish a standard of specific conduct that is capable of violation. Even if Gulf Federal's conduct were "inconsistent with sound and economical home

---

[5] We pretermit deciding whether violation of such laws would give rise to the Board's cease and desist power. The "violation of law" provision of section 1464(d)(2)(A) may be subject to the same limits as the "unsafe or unsound practice" provision discussed in Part III above. If so, the cease and desist power would arise only when an association violates a law which protects the association's financial integrity.

financing," the association would not have violated a law, it merely would have failed to meet the eligibility requirements for a federal savings and loan association.

More importantly, Gulf Federal's confused use of the inconsistent 365/365 interest calculation language in its contracts does not constitute action "inconsistent with sound and economical home financing." The Board concluded that the "sound and economical" provision was designed to protect borrowers from unfair lending practices. We disagree. Section 1424(a) disqualifies an institution when its "financial condition" is unsafe or its financial policy is not "sound and economical." The legislative history indicates that the possibility of bank failure was a foremost concern during the 1932 session in which section 1424(a) was enacted. *See, e.g.*, 75 Cong.Rec. 14456 (1932) (remarks of Sen. Fletcher). The more reasonable interpretation of the "sound and economical" provision is that it denies a federal charter to savings and loan associations whose policies may lead to future insolvency, not that it guarantees inexpensive mortgages to homeowners. While Gulf Federal's interest calculation provision mix-up is unfortunate, it does not threaten the association's financial well-being.

Some legislators evidenced a belief that the emphasis on "sound and *economical*" financing provided for inexpensive home financing. *See, e.g.*, 75 Cong. Rec. 14453 (remarks of Sen. Watson). But even if this history is accepted as controlling it would not support the Board's argument. The Board does not object to the 365/360 method because it is too expensive; it objects to the method because the loan agreement called for use of a different method. Thus, Gulf Federal's policy is not uneconomical, it is only inconsistent. It does not violate section 1424(a) even

if the section is interpreted to require economical lending practices.

B. *Federal Common Law*

The Board also found that Gulf Federal had violated federal common law and that this violation gave rise to the cease and desist power. The violation of federal common law identified by the Board was Gulf Federal's "breach" of the loan agreements. The Board concluded that state law and federal law were equivalent, and that it was not necessary to determine which law should be applied to Gulf Federal's conduct. It then cited the Restatement of Contracts, Louisiana case law, and cases from other states, in support of the black letter principle that unambiguous terms in a contract are to be enforced under their ordinary meaning. Because Gulf Federal had failed to calculate interest by the 365/365 method specified in one sentence of the loan agreements, the Board concluded that Gulf Federal had breached the loan agreements under federal common law.

The Board cited cases such as *Murphy* v. *Colonial Savings and Loan Ass'n*, 388 F.2d 609 (2d Cir. 1967), and *Rettig* v. *Arlington Heights Federal Savings and Loan Ass'n*, 405 F.Supp. 819 (N.D.Ill 1975), for the proposition that Congress has preempted state law in matters relating to federal savings and loan associations. *Murphy* held that management's duty to supply dissident shareholders with a shareholder list was governed by federal law and called for little more than an interpretation of the Board's regulations. *See* 388 F.2d at 611. *Rettig* held that federal law determined the extent of management's fiduciary duty when senior officials took personal advantage of a potential corporate opportunity. *See* 405 F.Supp. at 824. Neither case suggested that all conduct by a

savings and loan is governed by federal law. These cases, and others like them cited by the Board, stand only for the proposition that federal law governs the *internal management* of federal savings and loan institutions.

Gulf Federal's conduct in this case, however, has nothing to do with the internal management of the association. The disputed loan agreement provision is part of a contract between the association and its borrowers. Such contracts do not implicate the sound management of the savings and loan or the insurance liability of the government, nor do they require a uniform federal rule to assure sound and well-managed savings and loan institutions. *See DeSimone* v. *Warwick Federal Savings and Loan Ass'n*, 482 F. Supp 1190, 1194 (D.R.I.1980). Federal law does not establish whether Gulf Federal breached its agreements. Gulf Federal's loan agreements were made under Louisiana law, and Louisiana law must determine the rights of the parties to the contract.

C. *Louisiana Law*

The Board also suggested that Gulf Federal had breached the loan agreements under Louisiana law. According to the Board, a breach of contract is a violation of Louisiana law, and this violation gives rise to the Board's cease and desist authority. We reject this conclusion. Even if a breach of contract is the kind of "violation of law" contemplated by section 1464(d)(2)(A), an issue we expressly pretermit,[6] Gulf Federal did not breach its agreements under Louisiana law.[7]

---

[6] See note 5, *supra*.

[7] We originally certified this issue to the Supreme Court of Louisiana because we considered it determinative of the out-

No party has suggested that Gulf Federal acted in bad faith in drafting its loan agreements. Each loan agreement calling for use of the 365/365 method also included on its face a statement of the exact amount of each payment of principal and interest to be made by the borrower, which amounts were calculated under the 365/360 method. Because the amount of payment specified in the contract was not calculated under the method specified in the text of the contract, the terms of the agreement are in conflict, and the contract, read as a whole, is ambiguous.

Under Louisiana law, the choice between conflicting contractural provisions is made to reflect the probable intent of the parties. *See Bolding* v. *Eason Oil Co.*, 248 La. 269, 178 So.2d 246, 250 (1965) (contract, viewed as whole, showed "vendor" should have been entered instead of "purchaser"); *Cerniglia* v. *Kral*, 170 La. 372, 127 So. 872, 873-74 (1930) (aberrant clauses disregarded); *Union Ferry Co.* v. *Southern Improvement and Ferry Co.*, 124 La. 759, 50 So. 704, 706 (1909) (course of dealing relevant when clauses conflict); *Peavy-Byrnes Lumber Co.* v. *Long-Bell Lumber Co.*, 55 F.Supp. 654, 659 (W.D.La. 1944) (conflicting clauses in succeeding paragraphs governed by clause appearing in first paragraph). Under this principle, we are persuaded that Gulf Federal did not breach the agreements. The sentence calling for the 365/365 method of calculating interest was located in the midst of complicated text of the loan agreement, and apparently was ignored by all but one borrower. Even Gulf Federal's loan officers were unaware of its meaning. The typewritten

---

come of the appeal. That court refused certification. For this reason, we have made our own determination of the state law issue.

amount of the monthly payment, by contrast, was a matter of meticulous concern, both for the borrowers and for Gulf Federal. In a transaction of this nature, it defies common sense to believe that the parties were more intent on specifying the method under which interest was to be calculated than they were on agreeing on the amount of monthly payments. Moreover, no borrower has filed or even suggested an action against Gulf Federal for breach of contract. Indeed, a brief filed in this case by borrowers of Gulf Federal takes Gulf Federal's position against the Board. This is additional evidence that, in the view of its borrowers, Gulf Federal performed its part of the agreement. Accordingly, we find that the intent of the parties was that monthly payments were to be made in the specific amount typewritten on the face of the loan agreement. Gulf Federal thus did not breach the loan agreements under Louisiana law. Because Gulf Federal's actions violated no law, the Board's cease and desist power cannot be asserted.

V.

In summary, we hold that the Board may use its cease and desist power when a savings and loan association commits an "unsafe or unsound practice" or a "violation of law." The "unsafe or unsound practice" provision, however, refers only to practices that threaten the financial integrity of the association. Gulf Federal's conduct in this case poses no such risk. Gulf Federal has violated none of the laws suggested by the Board. We pretermit deciding which laws, when violated, may give rise to the cease and desist authority. The petition for review is granted, and the decision of the Board is

REVERSED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 78-2549

October Term, 19

FHLBB 77-171

GULF FEDERAL SAVINGS AND LOAN ASSOCIATION OF JEFFERSON PARISH, PETITIONER

versus

FEDERAL HOME LOAN BANK BOARD, RESPONDENT

Petition for Review of an Order of the
Federal Home Loan Bank Board

Before CHARLES CLARK, TJOFLAT and GARZA, Circuit Judges.

JUDGMENT

This cause came on to be heard on the petition of Gulf Federal Savings and Loan Association of Jefferson Parish, for review of an order of the Federal Home Loan Bank Board, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the Federal Home Loan Bank Board in this cause be, and the same is hereby reversed;

IT IS FURTHER ORDERED that respondent pay to petitioner, the costs on appeal to be taxed by the Clerk of this Court.

July 17, 1981

A true copy

Test: GILBERT F. GANUCHEAU
Clerk,
U.S. Court of Appeals
Fifth Circuit

By: R. ADELINE BARNES
Deputy
New Orleans, Louisiana

Issued as Mandate: Nov. 17, 1981

APPENDIX C

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT *

No. 78-2549

GULF FEDERAL SAVINGS AND LOAN ASSOCIATION OF JEFFERSON PARISH, PETITIONER

v.

FEDERAL HOME LOAN BANK BOARD, RESPONDENT

Nov. 5, 1981

Petition for Review of an Order of the Federal Home Loan Bank Board

ON SUGGESTION FOR REHEARING EN BANC

(Opinion July 17, 1981, 651 F.2d 259)

Before CHARLES CLARK, TJOFLAT and GARZA, Circuit Judges.

BY THE COURT:

Treating the suggestion for rehearing en banc as a petition for panel rehearing, it is ordered that the phrase, "to prevent financial collapse," is deleted from the panel opinion dated July 17, 1981, at page 9312, line 16. The phrase, "to preserve the financial integrity of its members," is inserted in its place. The sentence, as amended, shall now read, "This departs entirely from the congressional concept of

* Former Fifth Circuit case, Section 9(1) of Public Law 96 452—October 14, 1980.

acting to preserve the financial integrity of its members." The petition for panel rehearing is DENIED. No member of the panel nor judge of this court in regular active service having requested that the court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16; Fifth Circuit Judicial Council Resolution of January 14, 1981), the suggestion for rehearing en banc is DENIED.

APPENDIX D

UNITED STATES OF AMERICA
Before The
FEDERAL HOME LOAN BANK BOARD

In the Matter of

GULF FEDERAL SAVING AND LOAN ASSOCIATION OF JEFFERSON PARISH

Metairie, Louisiana

Enforcement Proceeding

OPINION

I. BACKGROUND.

On March 9, 1977, the Assistant Secretary of the Federal Home Loan Bank Board (the "Board") served a Notice of Charges and Hearing (the "Notice of Charges") upon the Gulf Federal Savings and Loan Association of Jefferson Parish, Metairie, Louisiana ("Gulf Federal") pursuant to the Board's authority under Section 5(d)(2)(A) of the Home Owners' Loan Act of 1933, as amended [12 U.S.C. 1464(d)(2)(A).] ("HOLA"). The Notice of Charges alleged that Gulf Federal has engaged in an unsafe or unsound practice and that Gulf Federal has violated the "sound and economical home financing" provisions of the Federal Home Loan Bank Act [12 U.S.C. 1424(a), 1426(i).] (the "Bank Act") and the Federal common law by charging interest on some 444 mortgage loans at a rate greater than that specified in the contractual agreements with the bor-

rowers under those loans (the "Borrowers"). On April 12, 1977, a prehearing conference (the "Prehearing Conference") was held in which the Administrative Law Judge (the "ALJ") discussed the Notice of Charges with the Board's Office of General Counsel (the "OGC") and Gulf Federal. The ALJ summarized the Notice of Charges as alleging a violation of Section 5(d)(2)(A) of HOLA which authorizes the Board to take action against "unsafe or unsound practices," and violations of the Bank Act and of Federal common law. During the Prehearing Conference, Gulf Federal did not challenge the ALJ's summary of the charges and discussed the allegation of a violation of HOLA as well as those of the Bank Act and Federal common law. On June 1 and 2, 1977, a private hearing (the "Hearing") on the Notice of Charges was held before the ALJ.

After the Hearing, the OGC and Gulf Federal each filed Proposed Findings of Fact and Conclusions of Law ("Findings of Fact" and "Conclusions of Law"). The OGC's Conclusions of Law were supported by a separate brief (the "OGC Brief"). Gulf Federal's Conclusions of Law made reference to two supporting memoranda of law (the "Gulf Brief" and the 'Gulf Interest Memorandum").

On September 20, 1977, the ALJ rendered a Recommended Decision to the effect that Gulf Federal had charged interest on the 444 mortgage loans at a rate greater than that specified in the contractual agreements with the Borrowers and that such action was an "unsafe or unsound practice" within the meaning of Section 5(d)(2)(A) of HOLA. The Recommended Decision was accompanied by a Proposed Order that Gulf Federal (i) cease and desist such practice and (ii) return to each of the Bor-

rowers an amount equal to the overcharged interest on the contracts to date. On September 21, 1977, the ALJ forwarded the Recommended Decision and Proposed Order to the Board and requested that the Board order immediate distribution of the Recommended Decision and Proposed Order to the Borrowers. On October 18, 1977, the Board denied that request.

On October 6, 1977, the OGC filed its Exceptions to the Recommended Decision and Proposed Order, and on October 11, 1977, Gulf Federal filed its Exceptions together with a request for an oral argument before the Board on the Recommended Decision and Proposed Order. On November 23, 1977, the Board denied the request for oral argument.

In reaching a decision in this case, the Board has made a full, de novo review of the facts, the arguments of the parties and the views of the ALJ, as the same are set forth in the pleadings, the transcripts, the parties' Findings of Facts and Conclusions of Law and supporting briefs and memoranda, the Recommended Decision and the Exceptions thereto, all as contained in the record certified to the Board. The Board hereby adopts that record as the record in this case, and the Board finds that the 444 mortgage loan contracts which are the subject of this Opinion and the names of the 444 affected Borrowers are those listed in the List of Borrowers attached to the Recommended Decision. Such list is hereby incorporated into and made a part of this Opinion. The Board has also made an independent review and analysis of the laws and regulations pertinent to this case. Based upon such review and analysis of the record and of pertinent laws and regulations, the Board has determined not to accept the Recommended Decision but instead to issue this Opinion.

This Opinion constitutes the initial Opinion of the Board in this case. For reasons discussed hereinafter, the Board does not believe that, on the state of the record before it, it is able to render an opinion and final order with respect to all aspects of this case. In the Order accompanying and adopting this Opinion, the Board is requesting the parties to provide further information and argument on the issues the Board believes cannot be decided at this time. However, this Opinion constitutes the Board's findings of fact and conclusions of law on all issues determined in this Opinion, and all further materials submitted by the parties should treat those issues as determined and not subject to reargument.

II. WHETHER GULF FEDERAL'S PRACTICE CONSTITUTES A BREACH OF THE 444 LOAN CONTRACTS.

A. *The Disputed Loan Contract Provision and the Views of the Parties and the ALJ.*

1. The Disputed Loan Contract Provision.

The 444 loan contracts all contain the following provision regarding the calculation of interest on the underlying loans:

> All interest is to be calculated monthly on the basis of a 365-day calendar year, and charged for each day of the month, on any balance of the principal sum remaining due and unpaid. . . .

Notwithstanding that provision, Gulf Federal has engaged in the practice of calculating the interest due annually on each loan by use of so-called "365/360 day" interest tables. This has the effect of charging interest for 365 days during each year, but comput-

ing the interest accruing on each of those 365 days on the basis of only a 360-day year. When interest is calculated on this basis rather than on the "365/365 day" basis or the "360/360 day" basis, the result is that the borrower is charged an extra five days of interest per year, which extra charge increases his annual interest rate by an amount equal to 1/72 or .0139 multiplied by his annual interest rate.[1] None of the parties dispute these facts. [*See* Gulf Findings of Fact, No. 17; OGC Brief at 17; Tr. at 1/10 to 1/2, 3/6; Recommended Decision at 7.]

2. The Views of the Parties.

The OGC has argued, and the ALJ has found, that Gulf Federal's practice of calculating the interest due on the 444 loans on the 365/360 day basis of calculation is in breach of the express terms of the 444 loan contracts. [OGC Brief at 2, 38, 39; Recommended Decision at 17.] The OGC contends, and the ALJ found, that under governing legal principles

---

[1] If calculated on a "365/365 day" basis, interest would be charged for 365 days during each year and interest per day computed on the basis of a 365-day year. If calculated on a "360/360 day" basis, interest would be charged for only 360 days during each year and interest per day computed on the basis of a 360-day year. The annual interest charged under either of these bases is the same. The additional interest charged under the "365/360 day" basis has the effect of an increase in the annual interest rate of 5/360 or 1/72 or .0139. Thus to compute the additional interest per year, .0139 is multiplied by the face rate of interest. *See* Tr. at 316. For example, under the 365/360 method, a borrower with a loan at 9% would actually pay 9.125% (9% + (.0139 x 9%)). For the legality of such increased charges under the Truth-in-Lending Act, see note 42 *infra*. *See generally* Annot., *Computing Interest on Basis of 360 Days in Year, 30 Days in Month or Like, as Usury*, 35 A.L.R.2d 842 (1954).

the above-referenced provision of the 444 loan contracts must be construed as an express requirement that interest be calculated by means of the 365/365 day basis of calculation. [*Id.*]

Gulf Federal has contested the OGC's position and the ALJ's finding by arguing, in substance, that:

(1) the disputed provision in the 444 loan contracts is silent with respect to the interest table to be used, and that therefore, under Louisiana law, the custom of the community should be read into the loan contracts with the result that the 365/360 day loan tables may be used to calculate the interest [Gulf Findings of Fact, Nos. 6, 7, 9; Gulf Proposed Conclusions, No. 3; Gulf Exceptions, Nos. 4, 5, 8.];

(2) the 444 loan contracts incorporate by reference the terms of all of the resolutions adopted by Gulf Federal, with the result that use of the 365/360 day tables has become an express part of the 444 loan contracts [Gulf Findings of Fact, Nos. 21-24; Gulf Conclusions of Law, No. 6; Gulf Exceptions, Nos. 6, 9]; and

(3) even if the foregoing points do not make clear that Gulf Federal has not breached the 444 loan contracts, the Board does not have the authority to determine whether Gulf Federal's practice constitutes such a breach because the interpretation of a contract is a matter of state law and because the disputed provision has not yet been interpreted by a Louisiana state court [Gulf Findings of Fact, No. 27; Gulf Conclusions of Law, Nos. 3, 4, 13; Gulf Exceptions, Nos. 7, 10.].

As indicated above, the OGC contests Gulf Federal's argument that the 444 loan contracts are silent with respect to the basis of calculation to be used on the ground that the disputed provision expressly requires use of the 365/365 day basis of interest calculation. [Notice of Charges at 2.] Thus, the OGC argues, the custom of the community with respect to the basis of calculation tables is not relevant to the 444 loan contracts. [OGC Brief at 40.] Moreover, the OGC has argued that even if the disputed provision did not expressly require use of the 365/365 day basis of calculation, Gulf Federal's arguments as to the applicability of the custom in the community are not persuasive because Gulf Federal has not shown that use of the 365/360 day tables is the "custom" in the relevant community and because Gulf Federal has failed to show that such "custom" was known to, and therefore binding on, the affected Borrowers. [OGC Brief at 40-43.]

The OGC has not responded to Gulf Federal's argument regarding the effect of its resolutions, but it is reasonable to conclude that the OGC believes that the "express" requirements of the disputed provision would be controlling. For the purposes of this Opinion, the Board so concludes. As to Gulf Federal's argument that the Board has no authority to determine whether Gulf Federal has breached the 444 loan contracts until they have been interpreted by a state court, the OGC contends, simply, that the Board does have the authority to determine whether Gulf Federal's practice is in contravention of Section 5(2)(d)(A) of HOLA. [OGC Brief at 35-37.]

3. The Views of the ALJ.

In the Recommended Decision, the ALJ adopts the position of the OGC that the disputed provision

expressly requires Gulf Federal to calculate interest on the 444 loans by means of the 365/365 day basis of calculation. Accordingly, the ALJ rejects Gulf Federal's claims that custom in the community or its resolutions require a contrary interpretation. The ALJ does not address himself directly to the question of the Board's authority to determine whether there is a breach of contract, but he does rule that the Board has the authority under Section 5(d)(2)(A) to require Gulf Federal to return any overcharged interest to the Borrowers. Since the ALJ's Recommended Decision contains that ruling, and since it contains a determination that Gulf's practice does constitute a breach of the 444 loan contracts, it is clear that the ALJ is of the opinion that the Board has the authority under Section 5(d)(2)(A) to determine whether the contracts have been breached.

B. *The Law Governing Interpretation of the Disputed Provision.*

1. The Confusion Created by the Pleadings.

Intertwined with the arguments of the parties regarding the proper interpretation of the disputed provision of the 444 loan contracts is a controversy as to whether the disputed provision is to be interpreted in accordance with state or Federal law. Upon analysis, this controversy seems to be more apparent than real, at least insofar as the actual interpretation of the contract provision is concerned. However, due to the importance attached to this issue by the parties and the numerous references to this issue in the pleadings, the issue of governing law must be con-

sidered before a consideration of the merits of the breach of contract issue.

Gulf Federal has persistently argued that state law must govern all aspects of interpretation of the 444 loan contracts. The OGC, as part of its argument that Gulf Federal's practice is a violation of Federal common law, has argued that the Board's regulations have "fully occupied the field of loan contracts of Federal associations" [OGC Brief at 21.] and, in effect, have "incorporated by reference all general principles of law, including contract law, which govern the *interpretation* and exercise of loan contracts." [*Id.* at 22 (emphasis added).] The OGC then states that "[a]ny 'general' law thus adopted becomes Federal law" [*Id.*], and that "Federal law totally occupies the field" respecting the interpretation of loan contracts. [*Id.* at 25]. The OGC then argues that under these principles of general or Federal law, the 444 loan contracts cannot be interpreted in the fashion suggested by Gulf Federal and that, therefore, Gulf Federal's practice constitutes a breach of those contracts under Federal common law. [*Id.* at 26, 27.]

2. There Is No Reason For The Board To Rule That Federal Law Must Govern The Interpretation of Loan Contracts Entered Into By Federal Associations.

The merits of the arguments by the OGC discussed above are discussed later in this Opinion. [See Section III.C. *infra.*] The point to be recognized at this time, however, is that in pursuing its contention, the OGC has not argued that the substantive law applicable in this case differs depending on whether that law is Federal common law or state law. Nor has

Gulf Federal asserted such a difference. In reality, when the OGC analyzes the disputed contract provision in order to respond to Gulf Federal's arguments on the breach of contracts issue, the OGC uses numerous *state law* precedents to prove its point. [*Id.* at 37-43.] Moreover, in making its argument with respect to the applicability of Federal law, the OGC specifically notes that the Federal common law principles which it cites are also principles of Louisiana common law and statutory law. [*Id.* at 26, 27.]

As further discussed below [Section II.C.], there is no apparent difference in the principles of contract interpretation applicable to this case under Louisiana law and under Federal law. Thus, the Board will be equally as able to determine whether Gulf Federal's practice constitutes a breach of the 444 loan contracts under Louisiana law as under Federal law. This being so, it does not appear to be appropriate for the Board to rule in this particular case on the extent to which Federal law, rather than state law, must be used to interpret loan contracts entered into by Federal associations. Principles of judicial economy dictate that, if no different result is to be reached by applying Federal law rather than state law, no decision should be rendered requiring the application of either body of law. Such is the situation in this case. The need to abstain from fashioning a rule of Federal law when there is no significant conflict between some Federal policy or interest and the use of state law has been explained by Justice Harlan in *Wallis* v. *Pan American Petroleum Corp.*, 384 U.S. 63 (1966).[2] Accordingly, the Board does not rule

[2] "In deciding whether rules of federal common law should be fashioned, normally the guiding principle is that a significant conflict between some federal policy or interest and the

upon the question of whether the law to be applied in interpreting the 444 loan contracts is state or Federal law.

The Board's view that it is unnecessary to determine whether the 444 loan contracts should be interpreted by reference to the body of Federal or state law, however, does not take away from the fact that, whatever law is applied, this case arises under, and the rulings of the Board in this case become a part of, the Federal law. Any breach of contract found to exist in this case will be a violation of the Federal common law because the law fashioned by rulings of the Board with respect to the operations of Federal savings and loan associations is Federal, not state, law.

In this regard it must be recognized that both state and Federal tribunals may apply either state or Federal statutory and common law, or both, in order to determine the law of a given case. Depending on the circumstances, a Federal tribunal may apply state law in order to determine state law, Federal law in order to determine state law, Federal law in order to determine Federal law or state law in order to determine Federal law. The Board sits in this case as a Federal tribunal. As more fully discussed in Section III.C. of this Opinion, *infra*, numerous judicial decisions have made clear that claims against Federal

---

use of state law in the premises must first be specifically shown." 384 U.S. at 68. It should be noted, however, that this rule is not always followed. In *City Federal Savings and Loan Ass'n* v. *Crowley*, 393 F.Supp. 644 (E.D. Wis. 1975), the court, citing *Wallis*, questioned the ripeness of a decision in that case as to whether the internal management of Federal associations was to be governed by Federal law, but it decided to rule on the issue "in order to facilitate the future conduct" of the litigation.

savings and loan associations—including, specifically, breach of contract claims—arise under Federal law.[3] Thus, whatever bodies of law may be applied by the Board in order to determine whether Gulf Federal has breached the 444 loan contracts, the law being determined by the Board in this case is Federal law, and any breach of contract by Gulf Federal found to exist in this case will be in violation of the Federal common law.

C. *The Proper Interpretation of the Disputed Provision.*

1. The Plain Meaning of the Disputed Provision Is that It Expressly Requires Use of the 365/365 Day Basis of Interest Calculation.

The point of departure in the interpretation of a contract must be an analysis of the language of the contract itself and of its plain and ordinary meaning. In the instant case, the terms of the disputed contract provision support the contention of the OGC and the finding of the ALJ that the 444 loan contracts are not silent or ambiguous as contended by Gulf Federal, but that they clearly require that the 365/365 day basis of interest calculation be applied. The disputed provision is:

> All interest is to be calculated monthly on the basis of a 365-day calendar year, and charged

---

[3] *City Federal Savings & Loan Ass'n* v. *Crowley*, 393 F.Supp. 644 (E.D. Wisc. 1975). *See also Murphy* v. *Colonial Federal Savings & Loan Ass'n*, 338 F.2d 602 (2d Cir. 1967); *Rettig* v. *Arlington Heights Federal Savings & Loan Ass'n*, 405 F.Supp. 819 (N.D. Ill. 1975).

> for each day of the month, on any balance of the principal sum remaining due and unpaid . . . .

The disputed provision must be broken into its two component parts in order for its meaning to become clear. The first part states that "all interest is to be calculated monthly on the basis of a 365-day calendar year." This can mean nothing other than that a year, for the purposes of the interest calculation, is to consist of 365 days. There is absolutely no suggestion in this clause that interest may be calculated on the basis of a 360-day year, nor is there any room for ambiguity on the subject. The provision is express and unqualified.

The second part of the disputed provision reads ". . . charged for each day of the month . . . ." There is no ambiguity in this clause, either, and the ALJ so found, stating:

> "[e]ach day of the month," when extrapolated to a year means 365 days. Again there is not the slightest hint of a 360-day formula which might have created an ambiguity. [Recommended Decision at 8.]

This clause clearly states a requirement that interest is to be charged for each of the days of the calendar year.

Gulf Federal argues that the disputed provision refers to "a 365-day calendar year" only to establish the number of days for which interest was being charged. [Prehearing Conf. Tr. at 11; Recommended Decision at 10.] It notes that the disputed provision "makes no specific reference to which interest table is to be used" [Gulf Findings of Fact, No. 9], and argues, on the basis of the absence of any such reference, that the disputed provision is silent with respect

to whether interest is to be computed on the basis of 360 or 365 days. Such an interpretation, however, flies in the face of the plain meaning of the "365-day" language in the disputed provision.

At a minimum, Gulf Federal's argument fails to give effect to both component parts of the disputed provision. Such an interpretation of the interest-calculation provision would violate a cardinal rule of construction that all words of a contract are to be given meaning, if possible, *Gautreaux* v. *Harang*, 183 So. 349, 353 (La. 1938); *Flaherty* v. *Jackson*, 94 So. 316, 321 (La. 1922).

It is a fundamental principle of contract law, both in Louisiana and in other jurisdictions, that when the language of a contract is clear and unambiguous on its face it must be enforced exactly as written. The Louisiana Civil Code provides that in interpreting legal agreements, the courts are bound to give effect to the contract according to the true intent of the parties, and that:

> [T]he intent is to be determined by the words of the contract, when these are clear and explicit and lead to no absurd consequences. . . [La. Civ. Code. Ann. art. 1945 (West).]

This provision is often cited by Louisiana courts as requiring the courts to give effect to the "plain, ordinary and popular sense of the language used in the agreement". *McKinney* v. *American Security Life Insurance Co.*, 76 So.2d 630 (La. App. 1954); *accord*, *Texaco, Inc.* v. *Vermilion Parish School Board*, 244 La. 408, 152 So.2d 541 (1963); *Pratt* v. *McCoy*, 128 La. 570, 54 So. 1012 (1911).

The Restatement of Contracts (1932) states that in interpreting a written agreement:

> The ordinary meaning of language throughout the country is given to words unless circumstances show that a different meaning is applicable. [Restatement of Contracts § 235(a).]

Accord, Opelika Manufacturing Corp. v. *City of Hawkinsville, Georgia*, 525 F.2d 941, 943 (5th Cir. 1976); *Vogel* v. *Tenneco Oil Co.*, 465 F.2d 563, 565 (D.C. Cir. 1972); *United States* v. *926.787 Acres of Land*, 227 F. Supp. 361, 364 (E.D. La. 1964); *United States* v. *Warren Brothers Co.*, 365 F. Supp. 528, 530-31 (M.D. La. 1973); *Ardoin* v. *Central Louisiana Electric Co., Inc.*, 318 So.2d 5, 8-9 (La. 1975); *Roos* v. *Way*, 234 So.2d 489, 491 (La. App. 1970); La. Civ. Code Ann. art. 1901 (West); 4 Williston on Contracts, § 609 (1961); 3 Corbin on Contracts, § 542 (1960); *see also* U.C.C. §§ 1-205(4), 2-208(2). Under that principle the disputed provision must be interpreted and enforced to require Gulf Federal to utilize the 365/365 day basis of calculation.

When the two parts of the disputed provision, so interpreted, are considered in the context of Gulf Federal's practice of calculating interest on the basis of the 365/360 day interest tables, it is clear that Gulf Federal's practice is in breach of the express requirements of the 444 loan contracts. As the OGC indicated in its brief, at least two courts have interpreted the "365/360 day" formula for interest calculation as providing that interest is to be charged for each calendar day although it is computed on the basis of a 360-day year.[4] Gulf Federal admits that it followed

---

[4] OGC Brief at 38; *American Timber and Trading Co.* v. *First Nat'l Bank*, 511 F.2d 980, 982, n.1 (9th Cir. 1973), *cert. denied*, 421 U.S. 921 (1975); *Silverstein* v. *Shadow Lawn Savings and Loan Ass'n*, 50 N.J. 30, 237 A.2d 474, 477 (1968). *See also Haas* v. *Pittsburgh Nat'l Bank*, 60 F.R.D. 604 (W.D. Pa. 1973).

this practice. [Joint Exhibit No. 1.] In the face of the plain meaning of the disputed provision, there can be little doubt that Gulf Federal's practice is in breach of that provision.

2. Other Support for the OGC's Interpretation of the Disputed Provision.

The disputed provision was inserted into the Gulf Federal note pursuant to a resolution passed by the directors of Gulf Federal on June 10, 1969. This resolution indicates Gulf Federal's intention to change from the 365/360 method, then in effect at Gulf Federal, to a 365/365 method. The resolution adopted by the Board was as follows:

> Motion by Mr. Lucas, seconded by Mr. Mouledous, that the method of calculating Interest (sic) on the 360-day factor be changed to the 365-day basis.

If there can be said to be any doubt whatsoever as to the meaning of the contract provision, this resolution should dispel that doubt. The resolution states explicitly that the *method* of calculating interest—and not the *number* of days for which interest would be charged—was to be changed from a 360-day factor to a 365-day basis.[5]

---

[5] Mr. Mmahat, president of Gulf Federal, testified that "the resolution came out the wrong way" [Tr. at 4/8.] and that "the intention of the Board of Directors from the date [Gulf Federal] opened up was the use of the 360-day table calculated for 365 days a year. [*Id.* at 4/10.] Mr. Mmahat explained the language of the resolution as follows:

> [W]e had a provision in our loan contract that said that we were to use the 360-day table and that it was to be computed as of every day in the month. Okay, we attempted to clarify that and to spell out that it was going

The ALJ usefully contrasts the new language in the disputed provision and the language for which it was substituted. [Recommended Decision at 9.] The only change in the contract language, resulting

---

> to be calculated on 365 days in the year; so it would be 360 over for 365 days, and it would be very clear. . . . Okay, what was intended was that the word—the phrase "for every day in the month" be eliminated and that the calculation based on the 360-day table be done for 365 days a year. Okay, it would make it clearer, more meaningful. *Instead of that, this resolution got passed.* [*Id.* at 4/7 to 4/8 (emphasis added).]

Mr. Mmahat attributed the mistakes to "my not watching what I was doing and the untrained secretary of the Board writing the thing down." [*Id.* at 4/7.]

Similarly, during the Prehearing Conference, Mr. Mmahat stated:

> When I wrote it up I just didn't proofread it correctly when I sent it down to the printers because I was confused in the number of days in the year and the table to be charged. [Prehearing Conf. Tr. at 13-14.]

Mr. Mmahat testified that the "mistake" was discovered four months later and a new resolution was passed. [*Id.* at 4/8.] Nonetheless, the provision in issue was used for 444 mortgage loan contracts executed between July 3, 1969 and February 14, 1973 [Joint Exhibit No. 1.]:

> A. What happened next is that the gal ordered the new forms with additional language in it and decided to use up the old forms, and she just kept striking out each time, putting in what she thought was the corrected language.
>
> Q. When you say "next" that was after the June 10 meeting?
>
> A. This was right after the June 10 meeting, and it continued until our present supply of forms was exhausted. Then we went on to use the new printed forms which had been printed in the erroneous language. [Tr. at 4/9.]

in the disputed provision, was the substitution of "on the basis of a 365-day calendar year" for "by the use of the 360-day interest tables." The prior provision, then, stated that "All interest is to be calculated monthly by the use of the 360-day interest tables." To adopt Gulf Federal's interpretation of this change would be to say that the change in language resulted in no change in substance. As the ALJ pointed out, "[i]t is very clear that a 365-day calendar year is different from a 360-day interest table." [*Id.*]

A further argument briefed by both sides is that of "unilateral mistake." The OGC argues that unilateral mistake does not serve to relieve a party of its contractual obligations, absent a showing (1) that the error was made as to a fact which was a principal cause for making the contract, and (2) that the other party to the contract knew or should have known it was a principal cause. [OGC Brief at 6.] Gulf Federal admits its "mistake" [Recommended Decision at 9-14.], and fails to present a legal theory under which a mistake should excuse it from its contractual obligations. The ALJ specifically found that Gulf Federal has created a unilateral mistake [*Id.* at 14.], and this finding is supported by basic principles of contract law. 3 A. Corbin, Contracts §§ 606-609 (1960). The Board concludes that Gulf Federal's "mistake" does not excuse it from its contractual obligations.

There is ample case law in support of the proposition that when a loan agreement provides that interest is to be paid at the rate of "—% per annum", use of the 365/360 computation method is impermissible. *See, e.g., Silverstein* v. *Shadow Lawn Savings and Loan Association*, 51 N.J. 30, 237 A.2d 474 (1968); *Perlman* v. *First National Bank*, 15 Ill.

App.3d. 784, 305 N.E.2d 6 (1973). In *Silverstein*, the covenant in the contract in question stated only that the mortgagor agreed to "repay . . . the principal indebtedness with interest at the rate of five and one-half percent (5½%) per annum . . . ." There, the savings and loan association had originally used the 365/365 day basis of computation but had switched during the term of the loan to use of the 365/360 day basis. The court found that change of practice to constitute a breach of contract since computation of interest on the 365/360 day basis resulted in the payment of interest at a rate exceeding 5½% per annum.

The evidence introduced at the Hearing shows that Gulf Federal's loan contracts provide that interest was payable "at the rate of — (—%) per cent per annum" [FHLBB 4(a-g).] On the basis of fact alone, the *Silverstein* case is directly on point.

3. Gulf Federal's Defenses.

(a) The Incorporation by Reference of the Resolutions of Gulf Federal's Board of Directors.

Gulf Federal argues that, by virtue of a clause in each of the 444 loan contracts, all of the affected

---

[6] The appropriateness of using a 360-day year to calculate interest has been a much-litigated subject over the years. *See, e.g., Koos* v. *First Nat'l Bank*, 358 F. Supp. 890 (1973), *aff'd*, 496 F.2d 1162 (7th Cir. 1974); *Holisak* v. *Northwestern Nat'l Bank*, 297 Minn. 248, 210 N.W. 2d 413 (1973); *Ditmars* v. *Camden Trust Co.*, 10 N.J. 471, 92 A.2d 12 (1952); *Swistak* v. *Personal Finance Co.*, 175 Misc. 791, 24 N.Y.S.2d 80 (1940); *Figg* v. *Nicholes*, 101 Ind. App. 706, 200 N.E. 431 (1936); and other cases cited in Annot., *Computing Interest on Basis of 360 Day in Year, 30 Days in Month or Like, as Usury*, 35 A.L.R.2d 842 (1954).

Borrowers have expressly agreed to be bound by the resolutions of Gulf Federal's board of directors, and that, as a result, they all have impliedly agreed to Gulf Federal's use of the 365/360 day interest table. [Gulf Findings of Fact, Nos. 22-26; Gulf Conclusions of Law, Nos. 5, 6.] The contract clause referred to by Gulf Federal provides as follows:

> The [Borrower] further covenants and agrees and is specifically bound and obligated as follows:
>
> > 1. That the monthly payments, as herein provided, with any and all additional payments, as herein specified, shall be added together and the aggregate amount shall be paid by the purchaser each month in advance in a single payment, and shall be applied by the Association in the following manner:
> >
> > (a) First, to the payment of the said interest on the aforesaid note, at the rate hereinabove stipulated, on any balance of the principal remaining due and unpaid *in accordance with, the by-laws and resolution of the Association* and the rules and regulations of the Federal Home Loan Bank Board. [Gulf Findings of Fact, No. 22 (emphasis added by Gulf Federal).]

Gulf Federal appears to contend that, even if the disputed provision regarding calculation of interest set forth in the 444 loan contracts expressly requires use of the 365/365 day basis, the effect of that express provision may be overcome by the incorporation by reference of resolutions unilaterally adopted and, from time to time, modified by the board of directors

of Gulf Federal. Gulf Federal attempts to support this thesis by citing a 1968 OGC opinion stating that borrowers may contractually agree to make payments required by documents, such as association by-laws, outside the contract itself. [Gulf Findings of Fact, No. 25.] Gulf Federal provides no authority, however, for the proposition that the provisions of such outside documents would control or supersede express terms of the contract, at least without there being a specific provision to that effect.

Thus, Gulf Federal's argument on the impact of its resolution appears to be without legal support. Moreover, when the language of the above-cited contract clause is analyzed, it is evident that Gulf Federal's argument on this point is entirely without merit.

Gulf Federal would interpret the contract clause to mean that the *rate of interest* to be *paid* by the Borrowers is to be determined "in accordance with" the resolutions of Gulf Federal. Yet, subclause (a) of the contract clause, which subclause contains the "in accordance with" language, plainly modifies the phrase "shall be applied by [Gulf Federal]," not the phrase "shall be paid by the [Borrower]." Thus, the contract clause speaks not to what the Borrower must pay but to what Gulf Federal may do with whatever money he does pay. This interpretation is made even more clear by the fact that subclause (a) itself says that funds are to be applied "to the payment of the *said* interest . . . at *the rate hereinabove stipulated*. . . ." (emphasis added). Plainly, the words "said" and "rate hereinabove stipulated" mean that the subclause is not meant to modify the effective rate of interest, especially by the *subsequent* "in accordance with" language.

Accordingly, this defense by Gulf Federal is rejected.

(b) The Custom in the Community.

Having concluded that the disputed provision expressly requires that interest be calculated on the 365/365 day basis and that the provision, therefore, is not ambiguous, the Board need not address the arguments raised by Gulf Federal as to the custom in the community. Unless there is such ambiguity and uncertainty with reference to written provisions of a contract as to indicate need for explanation as to the intent of the parties, there is no need to look beyond the written words of the contract. *United States* v. *926.787 Acres of Land*, 227 F.Supp. 361 (E.D. La. 1964). It is only after a finding of ambiguity that a court looks to extrinsic evidence, including evidence relating to custom and usage, to assist in giving meaning to the words of the contract. *Major* v. *Bishop*, 462 F.2d 1277 (10th Cir. 1972). Usage is never admissible to contradict what is plain or to change an express contract. *Jones* v. *Chaney & James Const. Co.*, 399 F.2d 84 (5th Cir. 1968); *Chase Manhattan Bank* v. *May*, 311 F.2d 117 (3d Cir. 1962), *cert. denied*, 372 U.S. 930 (1963). Even under the Uniform Commercial Code, which generally is not applicable to mortgage transactions [*cf.* U.C.C. §§ 2-105, 9-104.], while the terms of an agreement and an applicable course of dealing or trade usage are to be construed as consistent with each other wherever possible, the express terms control the interpretation of the agreement when such a consistent construction is not reasonable. U.C.C. §§ 1-205(4), 2-208(2).

Custom and usage may be proved only to aid in the interpretation of the words of the contract, if ambiguity exists, or to add a provision to the contract that the parties have not expressed. 3 A. Corbin,

Contracts § 556 (1960). Since the Board has found that the disputed provision is express and unambiguous, it is not necessary for the Board to analyze whether the custom in the community is consistent with Gulf Federal's practice. Gulf Federal's defense as to custom and usage is rejected.

D. *The Authority of the Board to Determine that the 444 Loan Contracts Have Been Breached.*

1. Positions of the Parties and the ALJ.

Gulf Federal argues that the Board does not have the authority to determine whether Gulf Federal's practice constitutes a breach of contract because the interpretation of a contract is a matter of state law and because the disputed provision has not yet been interpreted by a Louisiana state court. [Gulf Findings of Fact, No. 27; Gulf Conclusions of Law, Nos. 3, 4, 13; Gulf Exceptions, Nos. 7, 10.]

The OGC does not cite any case support for the Board's authority to interpret the contract terms, although it assumes that the Board has the authority to "flesh out" its regulations by "fashioning and applying Federal Common Law." [OGC Brief at 25.]

The ALJ specifically determined that Gulf Federal's method of calculating interest, in light of the contract provision, "legally constitute[s] 444 separate breaches of contract." [Recommended Decision at 17.] He did not treat the question of whether the Board had the authority to make such a determination, but it may be assumed he would not have reached the question of breach of contract if he had determined that the Board had no such authority. The ALJ's Recommended Decision, then, implicitly as-

sumes the Board's authority to determine whether the 444 loan contracts have been breached.

2. The Board has the Authority to Determine That There Was a Breach of Contract.

The provisions of Section 5(d)(2)(A) contain a grant of authority to the Board to determine, in the first instance, whether an association has violated a law. That section, which provides for the Board to serve a notice of charges and to conduct a hearing, further provides that:

> [*I*]*f* upon the record made at any such hearing *the Board shall find that any violation* or unsafe or unsound practice *specified in the notice of charges has been established,* the Board may issue and serve upon the association an order to cease and desist from any such violation or practice. [12 U.S.C. 1464(d)(2)(A) (emphasis added).]

In order to "find [a] violation" of law the Board must, of necessity, make some determination as to the legality or illegality of the association's action.[7] Section 5(d)(2)(A) is a clear indication that Congress intended that such a determination be made.[8]

---

[7] Since the Board is granted authority under Section 5(d)(2)(A) to find a violation of law, *a fortiori* the Board must have authority to find a breach of contract—for whatever purpose: whether to aid in a determination of a violation of law or unsafe or unsound practice.

[8] That the Board's regulatory authority extend to violations of common law, including breach of contract, is well established by the case law. A discussion of the cases may be found in Section III.C. *infra*.

Gulf Federal argues that until a "proper forum" (i.e., a court) has decided that Gulf Federal is charging interest on the 444 loans at a rate other than that permitted by the contract provision, the Board should not decide that Gulf Federal's practice is improper. [Gulf Brief at 3.] Such a contention simply cannot stand, for its effect would be to tie the Board's hands in each case until a court of law had decided the very case in question. Such a policy of administrative abstention pending judicial action would frustrate the comprehensive regulatory scheme established by Congress.

The conclusion that the Board has authority to make initial determinations of law as a corollary to its cease and desist authority is supported by the legislative history of the 1966 amendments to HOLA, which suggest that Section 5(d)(2)(A) gave the Board authority to make a "preliminary determination" of whether a violation exists.[9] Moreover, it has been held that "[t]he functions and powers of the Board do not end with the promulgation of rules." *California* v. *Coast Federal Savings & Loan Association*, 98 F. Supp. 311 (S.D. Cal. 1951). More specifically, a court has stated that reviewing courts should give weight to the Board's determination, as an expert, as to whether an association's conduct constitutes a violation of law or an unsafe or unsound practice. *Beacon Federal Savings & Loan Association* v. *FHLBB*, 162 F. Supp. 350, 355 (E.D. Wis. 1958), *aff'd in part on another ground*, 266 F.2d 246 (7th Cir.), *cert. denied*, 361 U.S. 823 (1959). See also discussion in Section II.A.2.(a). *infra*. There-

[9] This legislative history is set forth in Section III.A.3. *infra*, and reference is made to that section for a discussion of that history.

fore, OGC's argument that the Board has the authority to find a breach of contract is well supported by the statute, its legislative history and case law.

III. WHETHER THE BOARD HAS THE AUTHORITY TO ISSUE A CEASE AND DESIST ORDER.

Having concluded that Gulf Federal's practice of calculating interest on the 444 loans by using the 365/360 method of calculation is inconsistent with the terms of the 444 loan contracts and, hence, constitutes a breach of those contracts, it remains for the Board to determine whether it has the authority to take any remedial action with respect to that practice. The OGC has argued, and the ALJ has agreed, that the Board has such authority by virtue of Section 5(d)(2)(A) of HOLA. Under that section, the Board is authorized to issue a cease and desist order requiring affirmative corrective actions by any Federal association found to have violated, among other things, a law, rule or regulation or found to have engaged in an unsafe or unsound practice.

The OGC contends that there are three separate grounds upon which the Board may issue a cease and desist order against Gulf Federal and under Section 5(d)(2)(A). These grounds are that Gulf Federal's practice constitutes: (1) an unsafe or unsound practice; (2) a violation of law in that it violates the sound and economical home financing provisions of the Bank Act; and (3) a violation of law in that it involves 444 separate and continuing breaches of contract in violation of Federal common law. Gulf Federal contests the Board's position with respect to all three alleged grounds for Board action, although, as discussed more fully below, its arguments have

not been directly responsive to the points made by the OGC. For example, Gulf Federal has not argued that its actions do not constitute violations of the sound and economical home financing provisions of the Bank Act (although it is safe to assume that Gulf Federal believes that its actions do not constitute such a violation). Rather, Gulf Federal has confined itself to the argument that the Board has no authority to issue a cease and desist order by virtue of a violation of the Bank Act. Nonetheless, Gulf Federal's general position may be fairly construed to be that, even assuming its practice has been contrary to the terms of the 444 loan contracts, that practice does not constitute a basis for the issuance of a cease and desist order on any of the three grounds suggested by the OGC.

The ALJ's Recommended Decision adopted only one of the three grounds for Board action suggested by the OGC. It concluded that Gulf Federal's practice constitutes an unsafe or unsound practice within the meaning of HOLA. The ALJ did not rule upon the other two alleged grounds for action by the Board.

The following portions of this Opinion will analyze the merits of each of the three grounds for Board action suggested by the OGC, including a discussion of the pertinent arguments made by the parties and the conclusions drawn by the ALJ with respect to each ground.

A. *Does Gulf Federal's Practice Constitute an Unsafe and Unsound Practice Within the Meaning of Section 5(d)(2)(A) of HOLA?*

1. The Positions of the Parties and the ALJ.

The OGC has suggested two separate bases for a finding that Gulf Federal's practice of calculating interest on the 444 loans by using the 365/360 day basis of calculation is an "unsafe or unsound practice" within the meaning of Section 5(d)(2)(A).[10] First, the OGC has argued that Gulf Federal's practice is unsafe or unsound because it represents an intentional deviation from the terms of the 444 loan contracts without notice to or the consent of the Borrowers. [OGC Brief at 7.] The OGC does not elaborate on this argument, but as discussed below, it appears that this argument rests upon the view that such action is contrary to generally accepted standards of prudence and, hence, is "unsound." By this argument the OGC appears to contend that no findings must be made as to whether Gulf Federal's practice has had or may have any negative impact on Gulf Federal's financial condition. The OGC's second argument rests upon a reading of the legislative history of Section 5(d)(2)(A) in order to define the term "unsafe or unsound practice" and upon an analysis of the facts of the instant case in order to

---

[10] In relevant part, Section 5(d)(2)(A) provides:

> . . . [I]f upon the record made at [a] . . . hearing the board shall find that any . . . unsafe or unsound practice has been established, the Board may issue and serve upon the association an order to cease and desist from the same, and further to take affirmative action to correct the conditions resulting from any such . . . practice.

determine that Gulf Federal's practice actually creates an "abnormal risk or loss or damage."

In response to these contentions by the OGC, Gulf Federal has argued that the broad interpretation of "unsafe or unsound" practices suggested by the OGC's first argument is inappropriate. Gulf Federal contends that only actions which affect the "financial stability" of the association may be considered unsafe or unsound within the meaning of Section 5(d)(2)(A). [Gulf Brief at 4; Gulf Conclusions of Law, No. 17.] applying the facts of the instant case, as well as certain collateral conclusions of law, to that standard, Gulf Federal contends that its practices have not affected its financial stability and, therefore, cannot be considered unsafe or unsound. [Gulf Brief at 4; Gulf Conclusions of Law, Nos. 10, 13]. Furthermore, Gulf Federal has argued that, quite apart from the potential impact of its practices on its financial stability, the Board has no authority to determine that Gulf Federal's practice is an unsafe or unsound one until a state court of competent jurisdiction has determined the practice to be improper. [Gulf Brief at 3; Gulf Conclusions of Law, No. 13; Gulf Exceptions, Nos. 7, 10, 12.]

In the Recommended Decision, the ALJ appears to have adopted the view that unsafe or unsound practices, while not strictly defined under HOLA, must be "harmful" in that they create a risk of loss or damage to the association. [Recommended Decision at 16, 17.] The Recommended Decision concludes that Gulf Federal's practices

> legally constitute 444 separate breaches of contract, and as such unsafe or unsound practices, which could subject [Gulf Federal] not only to substantial monetary losses up to the estimated

amount of $79,025.00; but in addition, as recognized by its President, a serious loss of reputation in the community which could have further far reaching adverse effects in terms of potential deposit withdrawals." [*Id.* at 17 (emphasis added).]

In order to analyze the merits of the contentions of OGC and Gulf Federal and the ALJ's Recommended Decision with respect to whether Gulf Federal's practice constitutes an unsafe of unsound practice within the meaning of Section 5(d)(2)(A), this Opinion will consider: the statutory meaning of the phrase "unsafe or unsound practice"; whether the evidence developed during the Hearing indicates that Gulf Federal's practice falls within that statutory meaning; and whether, as suggested by Gulf Federal, there are any other legal barriers to the issuance of a cease and desist order by the Board if the Board does conclude that Gulf Federal's practice does fall within the statutory meaning of "unsafe or unsound practice".

2. The Statutory Meaning of "Unsafe or Unsound Practice".

(a) The Board's Authority to Broadly Apply the Phrase.

As indicated in the OGC Brief,[11] Section 5(d)(2)(A) was added to HOLA as a part of the Financial Institutions Supervisory Act of 1966 (the "1966 Amendments") in order to strengthen the Board's regulatory and supervisory authority over Federal associations [12]

[11] OGC Brief at 8.

[12] Preamble to 1966 Amendments, 48 Stat. 128 (1966).

by providing the Board with certain intermediate powers which could be exercised upon findings that an association was engaging in an unsafe or unsound practice or was violating the law or Board rules or regulations. Prior to the 1966 Amendments, the phrase "unsafe or unsound practice" had been used in Section 407(b) of the National Housing Act (the "NHA"), permitting the Federal Savings and Loan Insurance Corporation (the "FSLIC") to terminate an association's deposit insurance,[13] and the phrase "unsafe or unsound operation" had been used in the former Section 5(d)(2) of HOLA permitting the appointment of a conservator or a receiver.[14] The 1966 Amendments inserted the phrase "unsafe or unsound practice" into the conservatorship provision which is now Section 5(d)(6)(A) of HOLA. [12 U.S.C. 1464 (d)(6)(A).]

The phrase "unsafe or unsound practice" is not further defined in these statutory provisions, and no cases which interpret the phrase appear to have arisen under those provisions. Similarly, the Board has not

---

[13] 68 Stat. 633, 12 U.S.C. 1730(e)(1). The phrase "unsafe or unsound practice" is also used in Section 8(a) of the Federal Deposit Insurance Act, permitting termination of insurance by the Federal Deposit Insurance Corporation. 12 U.S.C. 1818(a). The phrase "unsafe or unsound" has appeared in numerous state statutes governing banks and other financial institutions. *See, e.g.*, Cal. Fin. Code § 3100(c) ("conducting its business in an unsafe or unauthorized manner"); Mass. Gen. Laws Ann. ch. 167, § 5 (West) ("has conducted the business of such bank in an unsafe or unsound manner"). For state statutes containing the phrase "unsafe or unsound practice," *see, e.g.*, Me. Rec. Stat. tit. 9-B, § 231(1)(A)(1); Md. Ann. Code of 1957, art. 11, § 11; N.Y. Banking Law § 420-k (McKinney); Va. Code § 6.1-49.

[14] 68 Stat. 636.

promulgated any regulations, and the OGC has not cited any opinions, expressly defining the meaning of the phrase. Rather, the phrase consistently has stood alone, reflecting the intention of the Congress and of the Board that the Board may utilize its administrative expertise to determine, on a case by case basis, which practices are inconsistent with the standards of operation contemplated by HOLA and the comprehensive regulatory scheme promulgated thereunder. The Board's authority to broadly apply the phrase is of particular importance in a case such as this, since the purpose of the 1966 Amendments was to strengthen the supervisory authority of the Board and other Federal agencies over regulated and insured institutions such as Gulf Federal.[15] Thus, the phrase "unsafe or unsound practice" cannot be given a narrow or unbending definition. It is a broad and general formulation, which the Board may interpret in relation to the facts and circumstances of each case.

The interpretation and application of the phrase "unsafe or unsound practice" is an important and critical part of the Board's regulatory function and responsibility, as such is entitled to great deference by the courts. This has been made clear in numerous judicial decisions. *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965); *American Trucking Associations* v. *United States*, 344 U.S. 298, 310 (1953); *NLRB* v. *Hearst Publications*, 322 U.S. 111, 130-31 (1944); *Gray* v. *Powell*, 314 U.S. 402, 411-13 (1941); *Reich* v. *Webb*, 336 F.2d 153, 158 (9th Cir. 1964); *North Arlington National Bank* v. *Kearny Federal Savings & Loan Association*, 187 F.2d [illegible]4 (3d Cir. 1951); *Blooming-*

---

[15] Preamble to 1966 Amendments, 48 Stat. 128 (1966), *cited in*, *FSLIC* v. *Hykel*, 333 F. Supp. 1308, 1311 (E.D. Pa. 1971), *vacated as moot*, 468 F.2d 1386 (3d Cir. 1972).

field Federal Savings & Loan Association v. *American Community Stores Corp.*, 396 F. Supp. 334, 387-88 (D. Neb. 1975); *FSLIC* v. *Hykel*, 333 F. Supp. 1308, 1311 (E.D. Pa. 1971), *vacated as moot*, 468 F.2d 1386 (3d Cir. 1972); *Beacon Federal Savings & Loan Association* v. *FHLBB*, 62 F. Supp. 350, 355 (E.D. Wis. 1958), *aff'd in part on another ground*, 266 F.2d 246 (7th Cir.), *cert. denied*, 361 U.S. 823 (1959); *People* v. *Coast Federal Savings & Loan Association*, 98 F. Supp. 311, 316-18 (S.D. Cal. 1951).

Two cases illustrate the deference given by the courts to Board interpretations of HOLA provisions. In *North Arlington National Bank* v. *Kearney Federal Savings & Loan Association*, *supra*, the court stated that HOLA is a statute

> of the type which states a policy, provides for the project under consideration, lays down some general rules and prohibitions and leaves details to the Board . . . . [187 F.2d at 565.]

In *Beacon Federal Savings & Loan Association* v. *FHLBB*, *supra*, the court discussed a reviewing court's deference to a Board determination of an "unsafe or unsound" operation for purposes of the appointment of a conservator under what is now Section (d)(6)(A) of HOLA:

> The general rule is that courts reviewing the findings and conclusions of administrative agencies will give weight on doubtful questions to their informed judgment as experts in the field. . . . [T]his rule is applicable, particularly to the weight to be given the Federal Home Loan Bank Board's determination that certain conduct or actions, assuming them to be proved by the weight of the evidence, constitute a violation of

> law and regulation or constitute unsafe or unsound operations for a Federal savings and loan association. [*Id.* at 355.]

The question of court deference to the Board's interpretation of the 1966 Amendments was considered in *FSLIC* v. *Hykel, supra,* where the court stated that it would defer to the Board's interpretation. In *Hykel* the court held that certain activities of a suspended officer and director of a savings and loan association constituted "participation in any manner in the conduct of the affairs of the Institution" a violation of Section 407(h) of the NHA. In so holding, the court cited (i) the broad purpose of HOLA to strengthen the regulatory and supervisory authority of Federal agencies over insured banks and savings and loan associations and the "remedial" purpose of the NHA suspension provision

> to protect the institutions, the depositors who invest their funds in the institutions, and the interests of the Government which underwrites the insuring agencies from the activities of those in fiduciary positions which may tend to undermine public confidence in the integrity of these institutions [*Id.* at 1311.]

and (ii) the fact that the FSLIC's interpretation of the suspension provision was in a manner consistent with the other agencies having authority under the 1966 Amendments. [*Id.*] The court concluded that "[t]he interpretation of the statutory language by these agencies should be given effect." In so ruling, the court cited *Udall* v. *Tallman,* 380 U.S. 1 (1965), in which the Supreme Court upheld the Secretary of Interior's interpretation of an Executive Order and

an Interior Department order on the ground, *inter alia*, that

> [T]his Court shows great deference to the interpretation of the statute by the officers or agency charged with its administration. . . . [W]e need not find that its construction is the only reasonable one or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings. [*Id.* at 16.]

Thus, in deciding whether Gulf Federal's practice is an unsafe or unsound practice under Section 5(d)(2)(A), the Board must consider that the 1966 Amendments conferred upon the Board, as the regulatory and supervisory agency for Federal savings and loan associations, the responsibility to enforce the 1966 Amendments, which in *Hykel's* words had the remedial purpose "to protect the institutions, the depositors who invest their funds in the institutions, and the interests of the government which underwrites the insuring agencies." [333 F. Supp. at 1311.]

This broad authority of the Board under the 1966 Amendments is supported by their legislative history, which suggests that Congress intended the phrase "unsafe or unsound practice" to be "one of general application" which could be liberally applied to each fact situation to cover all activities which may be injurious to a regulated association. Congress, by declining to provide a statutory definition for the phrase "unsafe or unsound practice," appears to have accepted a statement contained in a memorandum submitted by Board Chairman John E. Horne (the "Horne Memorandum") to the House Committee on Banking and Currency, which memorandum became

part of the record of the House hearings [16] and the floor debates in both the Senate [17] and the House.[18] That statement was:

> The concept of "unsafe or unsound practices" *is one of general application which touches upon the entire field of the operations of a financial institution. For this reason, it would be virtually impossible to attempt to catalog within a single all-inclusive or rigid definition the broad spectrum of activities which are embraced by the term.* (Emphasis added.) [19]

Moreover, other parts of the legislative history indicate that Section 5(d)(2)(A) was considered a flexible supervisory tool which would provide a substitute for a multitude of detailed regulations. The following interchange took place during the Senate hearings:

> Senator Muskie. I have heard it said one reason favoring passage of this legislation is that you would be able to deal more effectively with individual cases of wrongdoing. And that you could reduce the necessity for the number of general regulations. . . .
>
> Mr. Horne. . . . [W]e would hope that it would not be necessary to issue as detailed regulations

---

[16] *Hearings on S.3158 Before the House Comm. on Banking and Currency*, 89th Cong., 2d Sess. 49-50 (1966) [hereinafter cited as *1966 House Hearings.*]

[17] 112 Cong. Rec. 25008.

[18] *Id.* at 26474.

[19] *1966 House Hearings* at 50.

> as we now sometimes issue or as many regulations as we sometimes issue . . . .[20]

Thus, it seems clear that Congress intended the phrase to encompass a "broad spectrum of activities."

(b) "Abnormal Risk or Loss or Damage" as an Indicium of an Unsafe or Unsound Practice.

Since Congress left the phrase "unsafe or unsound practice" as one of general application so that the Board could apply the word to changing circumstances, the Board must necessarily decide whether Gulf Federal's practice falls within the scope of the statutory phrase. While the Horne Memorandum and the apparent acceptance by Congress of the substance of the Horne Memorandum evidence the recognition by the Board and by Congress that the phrase "unsafe or unsound practice" is to be broadly applied by the Board without limiting the scope of the phrase by "all-inclusive or rigid definition," the Horne Memorandum does suggest one indicium of an unsafe or unsound practice. The Horne Memorandum stated:

> Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which

---

[20] *Hearings Before a Subcomm. of the Senate Committee on Banking and Currency on S.3158*, 89th Cong., 2d Sess. 19 (1966) [hereinafter cited as *1966 Senate Hearings*]. For other testimony to the same effect, see *id.* at 110-11 (testimony of Joseph P. McMurray, President of Queens College, City of New York and a former Chairman of the Board); *id.* at 181 (testimony of W. O. DuVall, Chairman of the Committee of Past Presidents of the United States Savings & Loan League); *1966 House Hearings* at 145 (testimony of Norman Strunk, Executive Vice President of the United States Savings & Loan League).

> is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.[21]

Both the OGC[22] and Gulf Federal[23] appear to accept the above language as an indicium of the meaning of the phrase "unsafe or unsound practice" in Section 5(d)(2)(A) of HOLA. The Recommended Decision does not expressly adopt the above indicium of unsafe or unsound practice contained in the Horne Memorandum, but the substance of the Recommended Decision and the fact that the Horne Memorandum is the only authority cited in the Recommended Decision for guidance as to the meaning of thhe phrase imply it was accepted by the ALJ. Similarly the Recommended Decision refers to the Horne Memorandum as support for the ALJ's conclusion that the concept of unsafe or unsound practice is to be liberally applied to cover practices which may be injurious to insured associations. [Recommended Decision at 16.]

---

[21] *1966 House Hearings* at 50.

[22] One of the OGC arguments does not rest on this indicium, suggesting that a practice may be unsafe or unsound even if there is no "abnormal risk or loss or damage." [OGC Brief at 10-12; see discussion *infra*.] But at the same time, the OGC describes the Horne Memorandum as "a cornerstone of the agency's enforcement posture" [OGC Brief at 11], and the OGC's other argument rests squarely on the "abnormal risk or loss or damage" concept [*Id.* at 12-15.]

[23] See Addendum to Guif Brief, describing the Horne Memorandum as providing the "main thrust of Congressional intent."

Under the indicium suggested by the Horne Memorandum, any practice which is "contrary to generally accepted standards of prudent operation" and which, "if continued," could have the "possible consequence" of "abnormal risk or loss or damage" to a Federal savings institution, its shareholders or the FSLIC may be an "unsafe or unsound practice" under Section 5(d)(2)(A) of HOLA. However, in order for a determination to be made as to whether a given practice is unsafe or unsound, the particular facts and circumstances must be considered. As stated in the Horne Memorandum,

> "[a] particular activity not necessarily unsafe or unsound in every instance may be so when considered in the light of all relevant facts. Thus, what may be an acceptable practice for an institution with a strong reserve position . . . may well be unsafe or unsound for a marginal operation." [24]

Certainly, the indicium of the existence of an unsafe or unsound practice articulated by the Horne Memorandum is no less restrictive than the whole meaning of the phrase "unsafe or unsound practice." If a practice meets the standard of that indicium of an unsafe or unsound practice, it is not necessary to consider whether that practice otherwise could be considered unsafe or unsound.

The OGC has suggested two reasons why Gulf Federal's practice is unsafe or unsound. The first contention—that Gulf Federal could be considered to have engaged in an unsafe or unsound practice simply because it had "intentionally deviated" from the terms

---

[24] *1966 House Hearings* at 49.

of the 444 loan contracts, irrespective of whether that action had the possible consequence of "abnormal risk or loss or damage" [OGC Brief at 7.]—does not rely upon the indicium of an unsafe or unsound practice suggested by the Horne Memorandum. The Board does not reach this contention because, as discussed in subsection 4.(c)., *infra*, the Board concludes that Gulf Federal's practice does have the possible consequence of "abnormal risk or loss or damage" and thus meets the more restrictive standard of the indicium of an unsafe or unsound practice suggested in the Horne Memorandum.

The OGC's second argument, however, rests squarely upon the indicium of unsafe or unsound practices suggested by the Horne Memorandum. Under that argument, the OGC contends that Gulf Federal's practice

> is contrary to generally accepted standards of prudent lending and creates an "abnormal risk or loss or damage" to [Gulf Federal] and to the FSLIC. [OGC Brief at 7.]

As indicated above, the Recommended Decision at least impliedly adopted the "abnormal risk or loss or damage" standard inherent in this argument by the OGC. [Recommended Decision at 17.] In order for the Board to accept the OGC's contention and the conclusion of the Recommended Decision that Gulf Federal's practices actually are "unsafe or unsound" under the indicium suggested in the Horne Memorandum, however, it is necessary that the Board find that those practices are *both* "contrary to generally accepted standards of prudent operation" and may have the possible consequence of "abnormal risk or loss or damage."

3. Gulf Federal's Practices Were Imprudent.

Gulf Federal's briefs and arguments to the ALJ did not address the issues in quite the fashion herein suggested, but part of its argument against the "authority" of the Board to find that Gulf Federal has engaged in unsafe or unsound practices can be understood as a challenge to the propriety of a finding that Gulf Federal's practice of using the 365/360 method of calculating interest on the 444 loan contracts is contrary to generally accepted standards of prudent operation." The OGC has contended that

> [p]rudent lending on the part of Federally insured savings institutions plainly dictates that they refrain from *committing themselves to a practice* of either intentionally or unintentionally violating contractual arrangements with borrowers. [OGC Brief at 13 (emphasis in original).]

Gulf Federal has asserted in response that its method of computation of interest is common in New Orleans and that its own practice has never been challenged in litigation by any of the Borrowers and has never been interpreted by "governing state law." [Gulf Conclusions of Law, No. 13; Gulf Exceptions, No. 7.] Although Gulf Federal does not spell out the implication of this assertion, it appears to suggest that Gulf Federal's practice—being common in the area and never determined by a court to be improper—cannot be considered "imprudent."

Similarly, Gulf Federal has suggested that even if the Board concludes that its practice is improper, it should not be considered an "imprudent" practice unless engaged in after the determination of impropriety has been made. Thus, Gulf Federal has

excepted to the *remedy* proposed in the Recommended decision on the ground that

> [W]hen Congress declined to be specific with respect to prohibiting practices and decided to grant "cease and desist" authority with a general reference to "unsafe and unsound practices" there necessarily became an educational aspect to disputes and hearings with respect to any asserted "unsafe or unsound practices" and until the final determination as to whether a given practice is unsafe or unsound, it would be improper and unfair to order, to the prejudice of the Savings and Loan Association, the repayment of monies received under a previously unadjudicated method. [Gulf Exceptions, No. 12. *See also* Gulf Conclusions of Law, No. 13.]

The Recommended Decision clearly rejected the suggestion by Gulf Federal that, for "educational" reasons or otherwise, Gulf Federal's practices should not be considered imprudent. The Recommended Decision concludes that Gulf Federal's practice legally constitutes 444 separate breaches of contract and "as such" constitutes an unsafe or unsound practice. [Recommended Decision at 17.] That conclusion appears to be warranted. Since this Opinion concludes that Gulf Federal's practice constitutes a breach of the 444 loan contracts, the Board also concludes that that course of action is imprudent.

The practice of entering into loan contracts and, thereafter, systematically breaching them, is imprudent. Gulf Federal contends that it did not believe it was engaged in such a practice and, hence, should not be accused of acting imprudently. But it is not necessary for a person to intend to act imprudently in order to so act.

The provisions of Section 5(d)(2)(A) are designed to permit the Board to determine which actions are imprudent and which may lead to abnormal risk or loss or damage, and to issue an appropriate cease and desist order that will prevent them. The legislative history of the 1966 Amendments suggests that Section 5(d)(2)(A) gave the Board authority to make a "preliminary determination" [25] of impropriety and to act upon that determination through a cease and desist order. No warning or "educational process" is required. Moreover, in making such a preliminary

---

[25] This interpretation of the Board's authority is supported by a debate in the House on the 1966 Amendments, which debate arose over the meaning of what is now Section 5(d)(4)(A) of the HOLA, which gives the Board the authority to remove an officer or a director, *inter alia*, if the Board finds that the officer or director has violated any law or engaged in an unsafe or unsound practice. In objecting to the wide authority granted the Board, Congressman Rhodes (R. Ariz.) stated:

> I point out the fact that the things for which an officer may be removed are ordinarily things which a court of law would determine, not an administrative board.
>
> If I understand the bill correctly, it would give to the Federal Home Loan Bank Board the authority to make a preliminary determination on any act which might add up to any of the enumerated malfeasances or misfeasances and thereby to remove an officer. [112 Cong. Rec. 24,987.]

If Congressman Rhodes' understanding of the provision was inaccurate, it would have been natural for a proponent of the provision to so inform him; instead, no one objected to Congressman Rhodes' assessment of the Board's authority under that provision to make a "preliminary determination" of "things which a court of law would [ordinarily] determine." [*Id.*] The Board's assessment of the breach claim is such a "preliminary determination."

determination, the Board is giving effect to its interpretation of the breadth of the phrase "unsafe or unsound practice."

Accordingly, the Board determines that Gulf Federal's practice is imprudent and that Gulf Federal's state of mind in this case is irrelevant to that issue. The Board concludes that Gulf Federal has breached the 444 loan contracts and that such breaches should be considered to be action "contrary to generally accepted standards of prudent operation" within the meaning of the indicium of an "unsafe or unsound practice" under Section 5(d)(2)(A) of HOLA.

4. A Possible Consequence of Gulf Federal's Practice Is Abnormal Risk or Loss or Damage.

Having concluded that Gulf Federal's practice is imprudent, the Board will determine further whether a possible consequence of Gulf Federal's practice is an "abnormal risk or loss or damage" to Gulf Federal or to the FSLIC.

(a) The Views of the Parties and the ALJ.

The OGC has suggested two possible consequences of Gulf Federal's actions which it believes constitute such an "abnormal risk or loss or damage." Those consequences are:

(1) the possibility that Gulf Federal will be sued for breach of contract with the result that it will be liable for an estimated $80,000 in actual damages plus interest. [OGC Brief at 14; Prehearing Conf. Tr. at 18.] The OGC con-

tends that, due to the continuing nature of Gulf Federal's breaches of contract, Gulf Federal's potential monetary liability is "ever increasing" [OGC Brief at 14.]; and

(2) the recognition by the community that Gulf Federal has been violating the terms of its loan contracts to the detriment of its borrowers may "seriously jeopardize the association's integrity and community standing." [*Id.*]

Gulf Federal has contended, however, that even if its practice is in breach of the 444 loan contracts, those breaches do not threaten Gulf Federal's financial stability. Gulf Federal supports this position by arguing that, due to the operation of the statute of limitations, Gulf Federal's liability for interest overcharges is limted to two years and is continually decreasing. [Gulf Conclusions of Law, No. 7; Gulf Interest Memorandum.] Furthermore, Gulf Federal argues that under Louisiana law Borrowers bringing suit against Gulf Federal could not collect legal fees and could only collect interest on overcharges from the day of filing suit. [Gulf Conclusions of Law, Nos. 8, 9.] Gulf Federal is contending, in effect, that its practice does not present an "abnormal risk or loss or damage" since the only potential financial consequence to Gulf Federal is that it may be required to return two years' worth of overcharged interest. Moreover, Gulf Federal contends that the likelihood of that consequence occurring is minimal because, to date, none of the Borrowers have challenged Gulf Federal's practice "in litigation." [26]

---

[26] Gulf Conclusions of Law, No. 13; Gulf Findings of Fact, No. 10. Gulf Federal concedes, however, that one Borrower did complain about Gulf Federal's practice. [Tr. at 156.]

The Recommended Decision appears to have concluded that both of the consequences suggested by the OGC—monetary liability and damage to reputation—are sufficiently possible to warrant a determination that Gulf Federal's practice is unsafe or unsound. [Recommended Decision at 17.] However, the Recommended Decision does not contain an analysis of the manner in which those consequences may be said to constitute abnormal risks or losses or damage, nor does it contain any findings as to the degree of impact of those consequences on Gulf Federal's financial condition.

(b) Gulf Federal's Argument that Its Potential Liability Is Limited by a Two Year Statute of Limitations Must Be Rejected.

The arguments made by Gulf Federal to show that the possible liability of Gulf Federal as a result of its loan practices is small are not well taken. Gulf Federal's primary argument in this respect is that the amount of interest on the 444 loans is limited by a two year Louisiana statute of limitations and, hence, is too small to constitute an abnormal risk or loss or damage. Gulf Federal also urges that because the interest component of the monthly payment on each loan decreases every month, the effect of the two year statute of limitations is not only to limit Gulf Federal's exposure but also to cause that exposure to decrease every year. [Gulf Conclusions of Law, No. 14.]

Gulf Federal bases this argument on Article 2924 of the Louisiana Civil Code, which is captioned "Rates of Interest, Usury." Article 2924 provides:

> The amount of conventional interest cannot exceed eight percent.[27] The same must be fixed in writing; testimonial proof of it is not admitted in any case.
>
> Except in the cases herein provided, if any persons shall pay on any contract a higher rate of interest than *the above*, as discount or otherwise, the same may be sued for and recovered within two years from the time of such payment. [Emphasis added.]

Gulf Federal contends that Article 2924 applies not only to actions for usurious interest but also to actions for overpaid, but nonusurious interest. Gulf Federal reasons:

> *When Louisiana Civil Code Article 2924 says "pay on any contract a higher rate of interest than [the] above," it means higher than the amount of interest agreed upon, i.e., conventional interest.* The Article then goes on to state that the borrower has two years from the time of payment to recover such overpaid interest. Therefore, under Louisiana Law only overpaid interest paid during the two years preceding the filing of suit can be recovered and therefore, the amount which could possibly be recovered by borrowers in this case is smaller and smaller each month. [Gulf Interest Memorandum at 2 (emphasis in original).]

---

[27] The eight percent limit has been raised to ten percent for obligations "bearing interest from date and secured in whole or in part, directly or indirectly, by a mortgage on immovable property." [La. Rev. Stat. Ann. § 9:3503 (West Supp. 4).]

That argument does not, however, take into account the fact that the words "the above" underscored in the second paragraph of Article 2924, as previously set forth, refer to the rate of "eight percent"—i.e. the usury limit. All of the cases applying the statute of limitations of Article 2924 have involved suits for the return of usurious interest,[28] and none have suggested that Article 2924's statute of limitations applies to actions to recover nonusurious, overpaid interest.

Therefore, there does not appear to be any basis for concluding that the two-year statute of limitations contained in Article 2924 would apply in this case. There is no suggestion that the interest charged to the Borrowers was usurious. The only allegation against Gulf Federal is that the interest was not calculated by the method specified in the mortgage loan contract and that the method of calculation actually employed resulted in a higher rate of interest being charged than authorized in the 444 loan contracts. Thus, the Borrowers' potential claims are for breach of the terms of the mortgage loan contracts. As pointed out by the OGC in its Brief, the statute of limitations in Louisiana for breach of contract is ten years. [OGC Brief at 50; *see* La. Civ. Code. Ann. arts. 1928, 3544 (West).]

Thus, Gulf Federal's argument as to the applicability of the Louisiana two-year statute of limitations to the instant case is plainly in error. The Board has already been presented with this argument in connection with the request of the ALJ that immediate distribution of the Recommended Decision

---

[28] *See* cases cited in note 125 to Article 2924 in West's Annotated Louisiana Civil Code.

be made to protect the rights of those Borrowers whose rights might be cut off by the operation of Article 2924.[29] In responding to the ALJ's request, the Board issued an order stating that it

> is not persuaded that the statute of limitations under Louisiana law which is properly applicable to any claims of the borrowers would bar any such claims[.] [Board Order of October 18, 1977.]

In so stating, the Board implicitly rejected the contention Article 2924 was applicable to the instant care. There is no reason for the Board to change the view.

During the Prehearing Conference, the OGC contended that the possible consequences of Gulf Federal's conduct involved not only Gulf Federal's liability for $80,000 but also Gulf Federal's liability for interest on that $80,000. [Prehearing Conf. Tr. at 27, 143.] In response to that argument Gulf Federal contends that under Article 2924 of the Louisiana Civil Code, Gulf Federal would only be liable for interest of 7% per annum from the date suit is filed. [Gulf Conclusions of Law, No. 8.] Thus, Gulf Federal's argument appears to be that any liability Gulf Federal might have for interest on the overcharges would be minimal. Gulf Federal is correct. Under Article 2924, Borrowers prevailing in an action would be entitled to 7% interest per annum only from the date suit was filed. Thus, the amount of Federal's

---

[29] The ALJ did not believe that Article 2924 applied to the instant case, but he felt that immediate distribution was necessary in the event that the statute was applicable. *See* Recommended Decision at 19 and the ALJ's Letter to the Board, accompanying the Recommended Decision.

liability for interest on the overcharges would depend on the time between the date suit was filed and the date Gulf Federal finally refunded the overcharges. Therefore, the Board does not consider interest on the amounts overcharged by Gulf Federal to have a material impact on the amount of damage which Gulf Federal may incur by virtue of its practice.

The ALJ commented during the Prehearing Conference that Gulf Federal would have legal fees as an added expense. [Prehearing Conf. Tr. at 28.] Gulf Federal apparently interpreted the ALJ's remark to refer to liability of Gulf Federal for the attorneys fees of prevailing Borrowers and in response cited *Lyons* v. *City of Shreveport*, 339 So. 2d (466 (La. App. 2d Cir. 1976). [Gulf Conclusions of Law, No. 9.] While *Lyons* did not involve a case where a prevailing party was claiming entitlement to recover attorneys fees from the losing party, *Lyons* does state a general rule that payment of attorneys fees of another must be pursuant to an agreement between the parties. [*Id.* at 469.] There does not appear to be any agreement between Gulf Federal and the Borrowers to this effect, and there is no Louisiana statute that would authorize such recovery. Thus, the Board will not consider any liability of Gulf Federal for the Borrowers' legal fees as a possible consequence of Gulf Federal's practice. However, Gulf Federal's incurrence of legal fees on its own behalf is a possible consequence of Gulf Federal's practice.

While the foregoing analysis with respect to the Louisiana statute of limitations indicates that Gulf Federal has failed to demonstrate that its exposure to liability for breach of contract is minimal or is decreasing, the Board will, nonetheless, determine whether Gulf Federal's practice may result in "ab-

normal" risk or loss or damage to Gulf Federal or the FSLIC.[30]

(c) The Meaning of the Term "Abnormal".

There are no precise guidelines as to what types of risks, losses or damage may be considered abnormal. Certainly the *degree* of risk, loss or damage may be a significant factor in considering whether the risk, loss or damage is abnormal. Thus, for example, the Horne Memorandum gave several examples of "unsafe or unsound practices," each of which was egregious and involved a high degree of risk, loss or damage. But the Horne Memorandum also cautioned that the degree of risk must be considered in the context of an association's financial condition. What may be an "acceptable" or normal risk for "an association with a strong reserve position . . . may

---

[30] It is not clear in the Horne Memorandum, which is here being used as an indicium of an "unsafe or unsound practice," whether in the phrase "abnormal risk or loss or damage" the term "abnormal" modifies only "risk" or modifies "loss" and "damage" as well. This Opinion *assumes*, solely for the purpose of analyzing this case, that "abnormal" modifies "risk" and "loss" and "damage." However, that reading is not required, and the Board is not hereby making any ruling or finding as to whether the indicium of an unsafe or unsound practice suggested by the Horne Memorandum necessarily involves abnormal loss or abnormal damage. The Board notes that analysis of the language of the Horne Memorandum could support a reading that the test is only a finding of "damage," not "abnormal damage." Such a conclusion would only strengthen the conclusions suggested by the following analysis. At all events, as previously discussed, the Board rejects the notion that in construing what constitutes an "unsafe or unsound practice," it is limited by an "all-inclusive or rigid definition."

be unsafe or unsound for a marginal operation." [*1966 House Hearings* at 49.]

The OGC contends that, given Gulf Federal's "already financially-strained operations" [OGC Brief at 14.], exposure to liability for nearly $80,000 in interest overcharges would constitute a risk, loss or damage sufficiently great in degree to be considered "abnormal." Evidence introduced into the record tends to support this view.[31] However, the Recommended Decision made no findings on this subject, and the record from the Hearing is not adequate to permit the Board to make such findings. Hence, the Board would have to obtain further evidence if it found that in order to determine whether Gulf Federal's practice creates the possibility of an "abnormal" risk or loss or damage, it had to determine the degree of impact of the possible consequences of that practice on Gulf Federal's financial condition.

Such a requirement, however, does not appear necessary. While degree is undoubtedly one aspect of abnormality, so also is deviation from the norm. The first dictionary definition of the word "abnormal" is "deviating from the normal; . . . irregular, unusual . . . ." [32] Only the second definition is "greater than or superior to the normal; excessive." [33] In the

---

[31] Prehearing Conf. Tr. 143-45; Tr. at 4/20. Gulf Federal stated:

> [I]t would be unsafe and unsound to give all of this money back. Eighty thousand dollars would have a severe effect upon reserves and our net worth and render a very strong, well-operated, law-abiding institution into a very weak financial position. . . . [Tr. at 4/20.]

[32] *Webster's Third New International Dictionary (Unabridged)* at 4 (1976).

[33] *Id.*

absence of any judicial, regulatory or statutory interpretation of the term "abnormal" as used in the Horne Memorandum, and in light of the fact that the Horne Memorandum states that the term "unsafe or unsound practices" is to embrace a "broad spectrum of activities," [34] it is reasonable to apply the primary dictionary definition to the word "abnormal."

Thus, an "abnormal" risk, loss or damage need not be one of great degree, and the Board does not need to make any specific findings as to the degree of impact which Gulf Federal's practice may have on its financial condition. Rather, the Board can determine, and does hereby determine, that the possible risk, loss or damage resulting from Gulf Federal's practice is "abnormal" in that it is "unlike" the kinds of risks, losses or damage which are inherent in and reasonably expected to occur from time to time in the operation of a financial institution. Lending is inherently a risk-taking business, but for lending to be conducted in a safe and sound fashion, it is of the essence that the risk-taking be reasonable and, to the extent practicable, planned and calculated.

In this respect, Gulf Federal's practice may be compared to the practice of a hypothetical association which decides to invest small portions of its funds on a random or "hunch" basis. Such an investment practice may not jeopardize a large enough amount of funds to threaten the association's financial stability, and it may even prove to be successful in that the association's "hunches" may frequently be correct, but the practice nonetheless presents an "abnormal" risk in that it is not the kind of risk that a prudent lender normally would take. As the supervisory authority over the lending practices of Federal asso-

---

[34] *1966 House Hearings* at 49.

ciations, the Board must do what it can to limit the risks taken by regulated associations to those that are reasonably planned and calculated at the outset. Those that are not may be found to be abnormal. In the instant case, since the Board agrees with the conclusion of the Recommended Decision that Gulf Federal's practice constitutes 444 separate breaches of contract, such a finding of abnormality is warranted. A continuing practice by a financial institution which is likely to result in suits against that institution and in losses from breach of contract produces a risk situation which is not normal.

(d) "Abnormal Damage" and Public Consequences to Gulf Federal and the FSLIC.

The ALJ found that Gulf Federal's actions could damage its integrity and community standing. [Recommended Decision at 17.] This finding is not fully developed, as the discussion in subsection (c) regarding "normality" illustrates. However, the testimony of the president of Gulf Federal certainly supports the finding.[35] Despite this lack of development in the record, this aspect of the Recommended Decision points to what the facts strongly suggest is at the core of the issues before the Board.

---

[35] Mr. Mmahat testified:

> [W]e fear . . . this getting out to the public and people talking about it and perhaps making the news. That's the greatest danger where it lays for us. [Prehearing Conf. Tr. at 128.] [F]orcing us to wave this proceeding out to the public . . . would do some business harm to us far beyond any harm that could come from us having to pay this interest back; and this is the thing that we've been very apprehensive about from the very beginning, and it's a very real danger. [*Id.* at 131.]

Perhaps to a greater degree than most single family mortgage loan notes in use today, the Gulf Federal note stated in detail and in words capable of being understood by the thoughtful borrower the method by which interest would be computed. Notwithstanding that, Gulf Federal has disregarded the terms of the note, arguing that the language is ambiguous. Now, the association seeks not only to avoid refunding interest collected in excess of that earned under the terms of the note but also to continue wrongful interest computation in the future, arguing that the revelation of its conduct necessary to cure the mischarging could severely harm its reputation. This is a harsh, but we believe, essentially accurate reading of the facts in this case. Moreover, we believe that it can be said with certainty that this is the reading of the facts that would be given by the public generally.

Given this situation, a large issue of public credibility looms for Gulf Federal, for the FSLIC and for the Board. Can Gulf Federal, FSLIC insured institutions, and Board regulated institutions use documents in transactions with the public, both borrowers and depositors, which state a commitment which is then disregarded without any reasonable excuse or mitigation or cure and still maintain long-term public confidence?

The ALJ's finding as to the damage to Gulf Federal's reputation in the community if the association's practices for these 444 loans become generally known is well founded. *Perlman* and the other cases cited above [36] illustrate that non-corporate borrowers who can afford to litigate do not regard the charging of interest on a 365/360 day basis without contract

---

[36] See Section II.C. *supra.*

authorization as a matter of slight concern. It is reasonable to believe that Gulf Federal's practice would appear to the public as "slick banking" or worse. The practice seems predatory, since the small sums involved often make individual protest uneconomic and since such practice is often hidden in ambiguous loan terms or, as here, represents total disregard for what the loan contract is fairly read to provide.

Whatever public toleration might have allowed even one decade ago, experience suggests that today such practices are viewed by many citizens as indicative of a lack of necessary public concern and responsibility among the country's financial institutions. As a regulatory agency which has a direct relationship to the public, the Board takes note of this on its own volition.

Moreover, the legislative history of the 1966 Amendments supports a consideration by the Board of such public consequences. During the Senate hearings, Senator Proxmire (D. Wis.) stated that the

> activities ["of the crooked operator and those interested solely in a 'quick dollar' "] could undermine public confidence in the soundness of financial institutions. . . . [112 Cong. Rec. 20,233.]

In connection with that and other statements Senator Proxmire introduced into the *Congressional Record* a *Washington Star* article, which read in relevant part:

> [R]egulators can't make an all-out public effort to push Congress into [passing the 1966 Amendments], for fear that they might do the very thing they want to prevent—that is, cause the

> public to worry about the safety of money in savings accounts.
>
> Inded, publicity already given to the pending legislation has caused some executives of thrift institutions to worry that the public's confidence was being shaken.
>
> If the savings public is made even slightly panicky, funds might be drawn out of accounts in banks and savings and loan firms—thus adding to the regulators' other big source of current woe, tight money. [*Id.* at 20,247.]

In response to a statement by a witness during the Senate hearings to the effect that Congress' concern should be the preservation of public confidence and of the rights of bank officials, Senator Douglas (D. Ill.) stated: "This is completely the aim of Congress and I am sure it is the aim of the Federal Home Loan Bank Board." [*Id.* at 235.]

Further, the legislative history indicates that a specific link was made between a public loss of confidence in one association and a similar loss of confidence in associations generally. The Senate Report stated that the testimony at the hearings "fully supported the position taken" in a letter by agencies requesting the legislation, which letter said that "[e]ven though few in number, improperly conducted institutions could cause public concern that might extend to the entire industry." [Senate Comm. on Banking and Currency, Financial Institutions Supervisory Act of 1966, S. Rep. No. 1482, 89th Cong., 2d Sess. 4-5 (1966).] To the same effect was a statement in the Senate hearings and Senate floor debate by Senator Bennett (R. Utah), the ranking minority member of the Senate Banking and Currency Committee:

> Although the instances of misuses of funds and intentional, irregular or unlawful practices are relatively few, when they occur, their influence is widespread and the publicity which results can have a very detrimental effect on the whole system.[37]

During the same hearings, Bryce Curry, President of the Federal Home Loan Bank of New York and Board district supervisory agent, testified:

> [I]n the financial business you really can't stand very many problem cases without undermining confidence.
>
> * * *
>
> Senator Sparkman. And you think the purpose of this legislation . . . is to give protection, insofar as we can, to the well-run associations, the honest savers and depositors, and try to work as much security as we can?
>
> Mr. Curry. Senator, if I operated one of these institutions . . . I would consider it in my self-interest.[38]

---

[37] *1966 Senate Hearings* at 6; 112 Cong. Rec. 20234 (1966).

[38] *1966 Senate Hearings* at 76. Mr. Curry elaborated:

> We appreciate, we believe and we feel that if we have major problems anywhere in the financial business, then the best-run institutions also have problems. It is not like the grocery business. You know, if we have a couple of grocery stores operating in an area and one of them through incompetency or mismanagement goes out of business, I am certain my wife would not be concerned, she would just go to the other one.
>
> But if there are two financial institutions, she might go to the one across the street, which was very well run, and take the money out. [*Id.* at 72.]

[Footnote continued on page 38]

Similarly, Edward L. Johnson of the Council of Savings & Loan Financial Corporations testified:

> Public confidence in all financial institutions can be shaken by troubles involving any one type of institution. The San Francisco National Bank failure, for example, had repercussions in the savings and loan industry. Thus, if I may be permitted a rough paraphrase of John Donne's famous sermon, if the bell tolls for any financial institution, there's no need to send for whom it tolls; it tolls for all of us. [*Id.* at 138.][39]

Thus, the legislative history indicates that the 1966 Amendments reflected in part a concern for the "widespread" effects on public confidence and, hence, on the well-being of all financial institutions, which the invidious practices of one institution could engender.

The community's expectation of the standards to which financial institutions conform cannot fairly be said to permit disregard for a clear, express term of a contract to the favor of the institution and at the expense of other parties to the contract. Such a situation may fairly be said to involve abnormal damage, both to the institution involved and to other insured institutions, because if not rectified, such a practice puts in question the essential fairness, integrity and concern for the commonweal of all such lenders. It is not necessary that such public ques-

---

[39] [Continued]

For a similar statement to the same effect by Ennis Oakes, President of the Federal Home Loan Bank of Little Rock, Arkansas, see *id.* at 69.

[39] For two letters to John E. Horne from associations expressing support for the 1966 Amendments, see *id.* at 419, 420.

tions create a risk to one or more institutions of the loss of business or deposits creating an immediate financial concern. Practices which are invidious and which can be fairly predicted to tend over time to continue to destroy public confidence may also constitute a risk of abnormal damage.

Given the contradiction between Gulf Federal's past and proposed conduct with regard to these 444 loan contracts and the terms of the contracts at issue, the Board finds that the possibility of abnormal damage to the association and to the FSLIC is a condition which exists in this case on the basis of the injury which, subtly but significantly, has accrued from Gulf Federal's actions and which will only worsen as long as those conditions continue.

5. Appropriate Remedies for Gulf Federal's Unsafe and Unsound Practice.

Having concluded that the Board is authorized under Section 5(d)(2)(A) of HOLA to issue a cease-and-desist order which may require Gulf Federal to take affirmative action to correct the conditions resulting from its practices in the instant case, the next issue is the appropriate remedy to be applied. The Proposed Order would require Federal to (i) cease and desist from charging the Borrowers interest except on a 365/365 day basis of calculation and (ii) return to the Borrowers the past overcharges. Gulf Federal opposes the imposition of such relief, arguing that even if its practice is in breach of the 444 loan contracts and even if that breach is deemed to be an unsafe or unsound practice, Gulf Federal should not be required to return the past overcharges. [Gulf Conclusions of Law, No. 15; Gulf Exceptions, No. 11.] Gulf Federal, at various points, has suggested several reasons for this conclusion.

(a) The Argument that the Board Has Only Cease and Desist Power.

First, Gulf Federal contends that the Board only has cease and desist power and cannot order other relief. To support this position, Gulf Federal cites *Heater* v. *FTC*, 503 F.2d 321 (9th Cir. 1974), which construed Section 5(b) of the Federal Trade Commission Act (the "FTCA"). [15 U.S.C. 45(b).] That provision provides the FTC with cease and desist authority but does not contain any express statement that such an order may require affirmative corrective action. In contrast, Section 5(d)(2)(A) of HOLA expressly provides that a cease and desist order may require an association "to take affirmative action to correct the conditions resulting from any . . . practice" covered by the Section. Accordingly, Gulf Federal's argument that *Heater* is authority for the proposition that under Section 5(d)(2)(A) the Board may not do more than order Gulf Federal to cease and desist from its practice must be rejected.

While Gulf Federal's reliance on *Heater* is misplaced, the language of *Heater* suggests another argument which, the Board believes, should be addressed in the interest of the finality of the determination in this case. This argument is that the authority of the Board under Section 5(d)(2)(A) of HOLA to issue orders requiring affirmative action to correct the conditions resulting from violations or unsafe or unsound practice does not embrace the authority to require the alteration of previous acts of transactions, or otherwise to affect retroactively the acts which constituted the violation or practice. Stated in very general terms, this argument is that the authority of the Board to order corrective action is limited to prospective actions only—that is, to orders

which only affect future actions of an association. A necessary corollary of this argument is that the Board lacks the authority to order restitution, since by its nature is retroactive in effect—that is, it is a remedy which affects past actions of the association. For the reasons set forth below the Board believes that this argument must be rejected.

The pertinent provision of Section 5(d)(2)(A) of HOLA reads as follows:

> *Such order may,* by provisions which may be mandatory or otherwise, *require the association* and its directors, officers, employees, and agents to cease and desist from the same, and, further, *to take affirmative action to correct the conditions resulting from any such violation or practice.* [Emphasis added.]

The Board believes that the plain language of this provision authorizes retroactive corrective action in an appropriate case. "Affirmative action to correct the conditions resulting from" an unsafe or unsound practice clearly contemplates action which affects past action. While arguably an association can "correct" a practice by ceasing it, the mere cessation of a practice may not "correct the conditions resulting from" the practice.

This case is one in which retroactive corrective action is appropriate. The Board has determined that Gulf Federal has breached its contracts and that such breach is an unsafe or unsound practice. One of the conditions resulting from that practice is that Gulf Federal has in the past received payments from its Borrowers to which it was not contractually entitled. Section 5(d)(2)(A) authorizes the Board to order affirmative action to correct this condition, that

is, to correct what amounts to unjust enrichment. The correction of unjust enrichment necessarily involves repayment.

Naturally, any order of the Board requiring repayment would be implemented in the future. In that sense, such an order would be prospective. However, such an order would affect previously completed transactions, that is, the 444 loan and the payments made under them. It would "undo" those payments to the extent that it would alter their characterization as having been properly received by the association. In that sense, such an order would be retroactive.

Upon analysis the sharp distinction between "retroactive" and "prospective" is seen as something of a chimera. In plain language, Gulf Federal has engaged in an unsafe or unsound practice; a condition resulting therefrom is unjust enrichment; corrective action is expressly authorized by statute; the statute is a remedial statute; Congress must be assumed to have intended effective remedial action; the only effective remedial action for unjust enrichment is restitution; and restitution is both prospective and retroactive in that it is performed in the future and affects past transactions.

It would not be effective remedial action for unjust enrichment for the Board to order Gulf Federal, the unjustly enriched party, not to do it again. For the Board to hold that Congress intended the quoted provision of Section 5(d)(2)(A) to be limited to prospective action only in the sense of "don't do it again" would make a mockery of the words of the provision.

(b) The Argument that the Board's Remedial Authority May Not Be Exercised in This Case.

Second, Gulf Federal contends that:

> when Congress declined to be specific with respect to prohibiting practices and decided to grant "cease and desist" authority with a general reference to "unsafe and unsound practices" there necessarily became an educational aspect to disputes and hearings with respect to any asserted "unsafe or unsound practices" and until the final determination as to whether a given practice is unsafe or unsound, it would be improper and unfair to order, to the prejudice of the Savings and Loan Association, the repayment of monies received under a previously unadjudicated method. [Gulf Exceptions, No. 12.]

Gulf Federal also cites the *Heater* case in support of this position.

The *Heater* case involved an FTC order that a businessman cease and desist from certain "unfair business practices" and refund the money secured by means of those unfair practices. The court set aside the portion of the order requiring a refund on the basis that remedial action was not authorized by Section 5 of the FTCA. In reaching that conclusion the court first noted that Section 5 of the FTCA does not expressly provide the FTC with remedial authority. [503 F.2d at 322.] The court then looked at the legislative history of Section 5 which showed that Congress

> withheld from the Commission the power to make a determination which would expose the businessman to liability for acts occurring before the

Commission gave the general definition specific meaning in a factual context. In particular, Congress rejected an amendment which provided a private damage suit based on a Commission finding of a violation of the Act. Senator Newlands, the principal sponsor of the bill and of the broad standard expressed the argument against inclusion of a damage suit:

"We are entering now upon a new field of inquiry as to what constitutes unfair competition. This commission, and ultimately the courts, will be called upon to make nice distinctions with reference to this matter for the purpose of determining what set of facts and circumstances constitute unfair competition. Here (in the proposed damage suit) we hold this sword of Damocles above every business man in the country, and either compel him to abandon a practice which perhaps he thinks is right, or to pursue litigation to the bitter end, when we want through this instrumentality not to punish, but to secure higher standards of conduct, by rules that will be laid down by this commission and sustained by the court, and which will have an educational effect upon the commerce of the country." 51 Cong. Rec. 13116, 63rd Cong., 2d Sess. (1914). [*Id.* at 324.]

While the decision in *Heater* may be appropriate as applied to the FTCA, it is wholly inappropriate when applied to the Board's remedial powers under HOLA. As indicated above, Section 5(d)(2)(A), unlike Section 5(b) of the FTCA, expressly confers remedial authority upon the Board. This fact, in itself, tends to negate any suggestion that such authority should not be used or should be used only in

limited and narrowly defined circumstances. Moreover, while Section 5(b) of the FTCA was passed "to secure higher standards of conduct . . . which will have an educational effect upon the commerce of the country," Section 5(d)(2)(A) of HOLA was passed to permit the Board to stop, and correct the conditions resulting from, practices which are "contrary to *generally accepted principles* of prudent operation . . . ." [*1966 House Hearings* at 50.][40] Thus, unlike Section 5(b) of FTCA, Section 5(2)(d)(A) of HOLA was not intended exclusively to raise standards but rather was also intended to allow the Board to correct situations such as those in the instant case in which generally accepted principles are being compromised.

Perhaps more important than either of these considerations, however, is the fact that HOLA, unlike the FTCA, is a part of a pervasive regulatory scheme. Federal savings and loan associations are regulated entities, subject to Board determinations of the

---

[40] The following statement of Senator Bennett (R. Utah), the ranking minority member of the Senate Committee on Banking and Currency, is contained in the Senate hearings and debates:

> As is often the case, the need for this legislation is determined not by a majority of the banks and savings and loan institutions but by the actions of a very small number of individuals in the management of financial institutions who are either incapable of proper management or who willfully disregard or circumvent the laws and regulations set forth for the protection of the banking and savings and loan systems of this country as well as the deposits of those who have placed them in these institutions with full trust and confidence that they would be properly used and protected. [*1966 Senate Hearings* at 6; 112 Cong. Rec. 20,234.]

propriety of their actions and the scope of their operations. Thus, comparisons between the authority of the Board and the FTC are inappropriate, and implied limitations on the FTC's authority cannot be assumed to be implied limitations on the authority of the Board.

Section 5(d)(2)(A) of HOLA authorizes the Board to order an association "to take affirmative action to correct the conditions resulting from" an unsafe or unsound practice. While there are no cases setting limits on this authority, the language of a case under Section 5(d)(1) of HOLA demonstrates that the Board generally has broad discretion in fashioning relief.

In *Beverly Hills Federal Savings and Loan Association* v. *FHLBB*, 371 F. Supp. 306 (C.D. Cal. 1973), the Board sought injunctive relief under Section 5(d)(1) of HOLA which provides, in pertinent part:

> The Board shall have power to enforce this section and regulations made hereunder. In the enforcement of any provisions of this section or rules and regulations made hereunder, *or any other law*, or in any other action, suit, or proceeding to which it is a party or in which it is interested, and in the administration of conservatorships and receiverships, the Board is authorized to act in its own name, and through its own attorneys. [Emphasis added.]

In holding that the Board had authority to enforce common law fiduciary duties under Section 5(d)(1), the court stated:

> [I]t is manifest that Congress envisioned a strong Bank Board with broad regulatory power

> to redeem and make viable the initial condition of charter issuance that "primary consideration [be given] to the best practices of local mutual thrift and home-financing institutions in the United States. . . ." Reich v. Webb, 336 F.2d 153, 158 (9th Cir. 1964). . . . If the remedy sought by the Board is within the general enforcement powers contemplated by the statute, then the Board has broad power in fashioning the appropriate relief. [*Id.* at 313.]

While *Beverly Hills* arose under Section 5(d)(1), it demonstrates the breadth of the remedial powers which Congress intended to give to the Board. Accordingly, Gulf Federal's arguments that that Board's remedial authority may not be exercised in this case must be rejected.

(c) The Argument that Return of the Overcharges Is Beyond the Board's Authority Because Such Return Would Be Harmful to the Association and Would Be an Unsafe or Unsound Practice.

Gulf Federal has also contended that the Board does not have the authority to require Gulf Federal to return the overcharged interest on the 444 loans since that would result in harm to the association. In fact, Gulf Federal alleges that the degree of harm to Gulf Federal would be so great that the ordering of such action would itself be an unsafe or unsound practice.

The Recommended Decision found that the "conditions resulting from" the unsafe and unsound practice were (i) the contingent liability and (ii) the risk of deposit withdrawals. With respect to the

contingent liability, Gulf Federal contends, in essence, that repayment of past overcharges would replace a contingent liability with a current liability. That, Gulf Federal seems to feel, is more of a threat to its financial stability than the unsafe or unsound practice with which it is charged. The Board has determined, however, that the contingent liability is only one of the "conditions resulting from" the "unsafe or unsound practice." The Board has concluded that the threat of deposit withdrawals and the potential legal expenses are also the "conditions resulting from" Gulf Federal's "unsafe or unsound practice." With respect to potential legal expenses, there is the possibility that Gulf Federal will incur large legal expenses in defending its conduct only to lose, thus having to pay sizeable legal costs as well as $80,000 in refunds.

One "condition" that the proposed relief would correct that does not raise issues of the appropriateness of the proposed corrective action, is the threat to the community standing of Gulf Federal and of other insured institutions if the 444 loan contracts are not enforced as written and if that fact becomes publicly known. For Gulf Federal, the damage might be obvious and immediate. Depositors could withdraw their savings and go to another institution in which they have greater faith,[41] and prospective borrowers could seek their loans elsewhere. Gulf Federal has argued that a Board order requiring Gulf Federal to return the overcharges itself might have

---

[41] One Borrower of Gulf Federal testified that he did close his savings account with Gulf Federal because "I couldn't get my interest calculations [on the loan] done correctly." [Tr. at 2/39.]

that effect. That argument will be the subject of further briefing as discussed below.

On the basis of the foregoing discussion, the Board concludes that the mere fact that a return of overcharges might be harmful to the association does not affect the authority of the Board to order such a return. Moreover, the Board concludes that even a fairly substantial level of harm to Gulf Federal would not necessarily make an order for the return an unreasonable or improper action on the part of the Board. The failure of the Board to order such return might have even more troubling consequences to Gulf Federal and other insured institutions.

(d) The Need for Further Briefing.

Nevertheless, the Board is of the view that the present state of the record does not permit it to decide on the proper remedy in this case. The considerations analyzed in subsection (c) above are cast in somewhat tentative terms due to the state of the evidence in the record. For example, the record does not appear to establish the precise amount of money by which the Borrowers have been overcharged. In addition, the Board wishes to consider alternative forms of restitution not discussed at all in the record. Among those alternatives are those suggested in the Truth-in-Lending Act [42] guidelines recently proposed

---

[42] The fact that use of the 365/360 day basis of calculation results in the Borrowers being charged interest at a rate higher than the contract rate raises the question of whether Gulf Federal's practice violates the Truth-In-Lending Act (the "TILA"). The OGC has not charged Gulf Federal with such a violation, and hence the question is not properly a part of the proceedings herein. Nevertheless, the Board notes

by the Board, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the FDIC and the National Credit Union Administration. [42 Fed. Reg. 55,786 (1977).] They are:

---

that Gulf Federal does appear to have violated the TILA with respect to at least one of the 444 loans.

Section 226.5(b) of Regulation Z under the TILA provides in pertinent part:

> Except as otherwise provided in this section, the annual percentage rate applicable to any extension of credit, other than open-end credit, shall be [the] nominal annual percentage rate determined . . . so that it may be disclosed with an accuracy at least to the nearest quarter of 1 per cent.

The "annual percentage rate" must "reflect a relationship between the amount financed and the finance charge." [Federal Reserve Board Publication Information Letter No. 281.] Letter 281 continues:

> Therefore, if a finance charge is assessed on a daily basis, there would be 365 such periods in a year, and it would be inaccurate to quote an annual percentage rate based on a 360 day year. If a creditor stated an annual percentage rate based on a daily method of computing interest, but actually computed interest on some other method which resulted in an inaccurate disclosure of an annual percentage rate *when rounded to the nearest quarter of a per cent*, such inaccuracy would be considered a violation of the Truth-in-Lending Act.

Thus, if the lender only discloses to the borrower the interest rate which appears on the face of the note, computed on a 360-day basis, whether or not the lender is in violation of Regulation Z depends on the effective yield of that interest rate when charged for 365 days. Whether or not the effective yield will be "disclosed with an accuracy at least to the nearest quarter of 1 percent" when only the face rate is disclosed depends on the basic interest rate itself. An 8% 360 day-loan has an effective yield over 365 days of 8.11% (8% + (.0139 x 8%)), which could be rounded to 8%. A 9% 360 day-loan

(i) restructuring the loan to reduce the number (not the amount) of required payments (maturity reduction method) and

(ii) lowering the amount of each remaining payment so that the total finance charge does not exceed that permitted. [*Id.* at 55,788.]

While all forms of restitution would affect Gulf Federal's net worth in the same manner, those forms which do not require immediate, lump sum repayment, but rather contemplate a restructuring of the loans, would have the least severe impact on Gulf Federal's cash flow. The Board requires further information on the net impact of the several forms of restitution on Gulf Federal and on the benefits which those forms will provide for the affected Borrowers.

Consequently, it is the opinion of the Board that the parties should present further briefs in accordance with the terms of the Order adopting this Opinion.

---

has an effective yield over 365 days of 9.125% (9% + (.0139 x 9%)), which could be rounded either to 9% or 9.25%. A 10% 360 day-loan has an effective yield over 365 days of 10.13% (10% + (.0139 x 10%)), which would have to be rounded to 10.25%. Thus, whenever the basic interest rate is more than exactly 9%, the lender would be required to round the annual percentage rate disclosed to the borrower upward to the next highest 1/4 of 1%.

Only one of the 444 loan contracts in question was at an interest rate greater than nine percent. Loan Number 554 had a face rate of 9.5% and therefore the effective yield of that interest rate under the 365/360 method is 9.63% (9.5% + (.0139 x 9.5%)). Gulf Federal had the choice of (i) disclosing the 9.63% rate or (ii) rounding the 9.63% to the nearest quarter which is 9.75% and disclosing that amount. Gulf Federal does not appear to have done this and thus appears to have violated Regulation Z on that loan.

B. *Gulf Federal's Practice Constitutes a Violation of the Bank Act's Sound and Economical Home Financing Provisions*

1. The Positions of the Parties and the ALJ.

The OGC argues that Gulf Federal's practice with respect to interest calculation violates the "sound and economical home financing" provisions of the Bank Act by overcharging the Borrowers by five days interest per year on each contract for each year the 444 loans have been in force. [OGC Brief at 15.] The OGC contends that, by violating the "sound and economical home financing" provisions of the Bank Act, Gulf Federal has violated the law and, therefore, may be subjected to a cease and desist order under Section 5(d)(2)(A) of HOLA.

The term "sound and economical home financing" is used in two places in the Bank Act. Section 4(a) [12 U.S.C. 1424(a).] of the Bank Act provides that a savings and loan association shall not be eligible to become a member of a federal home loan bank if "the character of its management or its home financing policy is inconsistent with sound and economical home financing, or with the purposes of this Act." Substantially the same language is found in Section 6(i) [12 U.S.C. 1426(i).] which, among other things, enumerates the grounds upon which a member institution can be expelled from a federal home loan bank.

Although the OGC argues that Gulf Federal has violated "sound and economical home financing provisions" of the Bank Act, the OGC does not specify, either in the Notice of Charges or in the OGC Brief, whether the OGC alleges that the *character of Gulf*

Federal's management or *Gulf Federal's home financing policy* is inconsistent with sound and economical home financing, or both. Thus, in analyzing the OGC's contentions on this issue, it is necessary to consider both possibilities.

Conversely, it is noted that the OGC does not allege, as it could by reference to the same provisions available in the Bank Act, that either the character of Gulf Federal's management or its home financing policy is inconsistent with the "purposes of the Bank Act". The allegations contained in the Notice of Charges and, therefore, the decision of the Board contained in this Opinion with respect to violations of the Bank Act are limited strictly to violations of the more narrow standard of "sound and economical home financing." The OGC's argument rests on the OGC's analysis of the legislative history of the Bank Act, which, in the view of the OGC, indicates that the purpose of the sound and economical home financing standard and the "main thrust [of the Bank Act] was the protection of depression-starved homeowners". [OGC Brief at 17 & 18.]

Gulf Federal, as we have already noted, has not responded substantively to the OGC's claim that Gulf Federal's practice violates the Bank Act. Gulf Federal's sole written mention of the Bank Act, found in its Conclusions of Law, argues only that the allegation that Gulf Federal is in violation of the Bank Act is irrelevant to the instant cease and desist proceeding since the pertinent provisions of the Bank Act relate solely to the criteria for Federal Home Loan Bank membership.[43]

---

[43] Gulf Federal urged that the ALJ conclude:

> 18. The asserted violation by Gulf Federal of the Bank Act is not appropriate to this proceeding seeking a cease

At the Prehearing Conference, Gulf Federal expressed this view as follows:

> We're discussing portions of the charges dealing with violation of the Bank Act which are just not relevant or material to this proceeding. . . . They make reference to the body of these things dealing with eligibility to become a member of the Federal Home Loan Bank. Now this hearing is not about eligibility to be members of the Federal Home Loan Bank. [Prehearing Conf. Tr. at 22, 23.]

At one point in the Prehearing Conference Gulf Federal's counsel came close to disclosing his view of the merits of the OGC's Bank Act claim, indicating that the Bank Act was not designed to regulate an association's conduct toward its customers:

> They [the Federal Home Loan Bank of Little Rock] are our bank to loan us money, to take care of our needs. That's what that act pertains to. There is nothing in [the Bank Act] that regulates our behavior with the borrower on the home loan. [*Id.* at 22.]

In the Recommended Decision, the ALJ does not rule on the OGC's claim that Gulf Federal violated the sound and economical home financing provisions of the Bank Act.[44] Instead, the Recommended Deci-

---

and desist order with respect to the method of Gulf Federal in computing interest because the Bank Act, and particularly the sections cited, deal with the eligibility to become a member of or the removal of a federal savings and loan association from membership in the federal home loan bank. [Gulf Conclusions of Law, No. 18.]

[44] The preliminary statement to the Recommended Decision erroneously suggested that Gulf Federal was charged with

sion is based entirely upon a finding that Gulf Federal's loan practices violate the unsafe or unsound practice standard in HOLA. At the Prehearing Conference the ALJ did not comment substantively upon Gulf Federal's argument that alleged violations of the Bank Act are irrelevant to this proceeding nor to the OGC's response that the "Supervisory Act of 1966 gives the Board authority to cease and desist any violation of law . . ." [*Id.* at 24.]

The OGC has filed an exception to the failure of the Recommended Decision to base the cease and desist order upon a finding that Gulf Federal's loan activities violate the Bank Act. [OGC Exceptions, Nos. 3, 4.]

---

violating the Bank Act by engaging in an "unsafe or unsound" practice. The ALJ stated:

> On March 9, 1977, the Assistant Secretary of the Federal Home Loan Bank Board served a notice of charges and hearing pursuant to resolutions numbers 77-171 and 77-172 upon the Gulf Federal Savings and Loan Association . . . alleging that respondent has violated the Federal Home Loan Bank Act and the federal common law by engaging in the unsafe or unsound practice of charging interest on some 444 mortgage loans at a rate greater than that specified in the contractual agreements with its borrowers. [Recommended Decision at 2.]

That statement is plainly in error. The Notice of Charges alleges that Gulf Federal "has violated the Federal Home Loan Bank Act, and Federal common law, *and* has engaged in an unsafe or unsound practice, . . ." [Notice of Charges at 1.]

2. OGC's Argument That Violation of the Bank Act is Grounds for a HOLA Order to Cease and Desist and for Affirmative Relief.

(a) Violations of the Bank Act Are Grounds for Relief Under Section 5(d)(2)(A).

The OGC argues that a violation of the Bank Act's sound and economical home financing provisions provide a basis on which the OGC can bring this action under Section 5(d)(2)(A) of HOLA for a cease and desist order and affirmative relief. Accordingly the OGC's argument for issuance of a cease and desist order for violation of the Bank Act requires that this Board make a threshold determination as to whether a violation of the Bank Act can serve as a basis for Board action under Section 5(d)(2)(A) of HOLA. To date the Board has never made a formal determination to that effect.

The OGC's view that the Board may issue a cease and desist order under HOLA by virtue of a violation of the Bank Act is based upon the language in Section 5(d)(2)(A) that authorizes the Board to issue an order to cease and desist from "any violation" of "a law." [OGC Brief at 28.] The OGC correctly points out that nothing in the legislative history of either the Bank or HOLA requires the Board to reply upon Bank Act remedies in place of HOLA remedies to cease and desist from "any violation" of "a law." [OGC Brief at 28.] The OGC argues that such a requirement would:

> totally emasculate the FHLBB's broad, remedial cease-and-desist authority, and would deprive the FHLBB . . . of [its] ability to enforce the stat-

> utes and regulations which Congress plainly requires [it] to enforce. [OGC Brief at 28.]

On the other hand, nothing in the legislative history of either act expressly states that Bank Act violations provide a basis for exercise of HOLA remedies. Nevertheless, as our discussion of the legislative history of HOLA indicates [See Section III.A *supra.*], in enacting the 1966 Amendments the Congress intended to invest the Board with broad discretion to fashion appropriate relief for violations of all the laws that it is charged with enforcing.

At a minimum, the authority of the Board to issue a cease and desist order for a violation of "a law" under Section 5(d)(2)(A) must be construed to include authority to issue such orders for violations of a statute that the Board is specifically charged with enforcing—in this case the Bank Act. To conclude otherwise, especially in the absence of any specific legislative history that defines this phrase, would render the phrase meaningless. Indeed, as indicated below in the discussion of the OGC's common law claim [See Section III.C. *infra.*], the courts have found that Section 5(d)(1) of HOLA authorizing the Board to bring a court action for enforcement of "any other law" contemplates that the Board can enforce violations of "fundamental principles of common law." [45] In the face of the courts' interpretation that the phrase "any other law" in Section 5(d)(1) permits the Board to bring an action for violation of the common law, it would be difficult to argue (and Gulf Federal does not make the attempt beyond a general denial of relevancy) that the phrase "law,

---

[45] *See Beverly Hills Federal Savings and Loan Association* v. *Federal Home Loan Bank Board*, 371 F. Supp. 306, 314 (C.D. Cal. 1973), discussed *infra* at 95-96.

rule, regulation or charter" contained in Section 5(d)(2)(A) does not permit the Board to bring an action for violation of the very statute that created the Board and which the Board is charged with enforcing.

(b) Acts Which Are "Inconsistent" with the Bank Act Are "Violations" of the Bank Act.

One further point needs to be clarified concerning the nature of a Bank Act violation. Neither of the parties discusses whether a practice which is "inconsistent" with sound and economic home financing and, thus, is grounds for denial of admission to or expulsion from the Bank system can properly be termed a "violation" of the Bank Act. A "violation may be defined as a breach of a right or duty or a failure to comply with or conform to provisions of a statute. Because a practice that is inconsistent with sound and economical home financing would fail to comply with or conform to provisions of the Bank Act, it can be argued logically that such a practice would "violate" the Bank Act.

No reported decisions specifically construe or define the elements of a "violation" of the Bank Act. However, in a series of cases denying the existence of a private right of action against associations that run afoul of the Bank Act's usury provision, the parties speak in terms of the association's "violation" of the Bank Act.[46] The usury section is closely analogous to the Bank Act's home financing sections

---

[46] *See Goldstone* v. *South Shore Federal Savings and Loan Ass'n*, 402 F. Supp. 1291, 1292-1293 (E.D.N.Y. 1975); *Cooper* v. *Baldwin-Bellmore Federal Savings and Loan Ass'n*, 390 F. Supp. 874, 876 (E.D.N.Y. 1975); *Chevalier* v. *Baird Savings Ass'n*, 371 F. Supp. 1282, 1283 (E.D.Pa. 1974).

in that it establishes a condition of eligibility for membership. It provides:

> No institution shall be admitted to or retained in membership or granted the privileges of non-member borrowers, if . . . [the cost to borrowers is] in excess of the lawful contract rate of interest applicable to such transactions . . . [Section 5, 12 U.S.C. 1425.]

Based upon a common sense treatment of the concept of a "violation," and in the absence of any argument to the contrary by the parties, it appears to be proper for the Board to construe a practice that is inconsistent with sound and economical home financing as a "violation" of the Bank Act.

On the basis of the foregoing discussion in subsections (a) and (b) of this subsection 2, the Board concludes that practices which are inconsistent with the Bank Act's sound and economical home financing provisions provide a basis on which an action can be brought under Section 5(d)(2)(A) of HOLA for a cease and desist order and affirmative relief.

3. The Meaning of "Sound and Economical Home Financing".

(a) Charter of Management and Home Financing Policy Are Separate Considerations and Only the Latter Is At Issue In This Proceeding.

As previously noted, both the eligibility and expulsion provisions in the Bank Act identify two separate and seemingly distinct aspects of an institution's operation that may be evaluated for consistency with sound and economical home financing: (1) the char-

acter of an institution's management and (2) its home financing policy. The Notice of Charges, the OGC Brief and the OGC's statements at the Prehearing Conference do not indicate whether the OGC's argument goes to the character of Gulf Federal's management, or its home financing policy, or both.

The plain language of the Bank Act's sound and economical home financing standard, however, suggests that the Board should specify whether the character of Gulf Federal's management or Gulf Federal's home financing policy or both are at issue. In view of the nature of the practice here in question we believe this Opinion should be limited to Gulf Federal's home financing policy. The arguments in this case largely concern Gulf Federal's home financing policy, not the composition or conduct of its management team. Furthermore, the remedy sought by the OGC and proposed in the Recommended Decision—a cease and desist order and refunding of the overcharged interest—is requested in order to cure the alleged defect in Gulf Federal's home financing policy but has little direct bearing on the character of Gulf Federal's management.

(b) The Statutory Language Supports OGC's Claim.

The language used in the Bank Act's eligibility and expulsion provisions suggests that when the Congress included the sound and economical home financing language it was not merely establishing an additional requirement for an association's financial stability. Both Section 4(a)'s eligibility provision and Section 6(i)'s expulsion provision contain conditions which unequivocably and solely concern the institution's financial condition. For example, Section 4(a) provides that no institution shall be eligible to become a

member if "its financial condition is such that advances may not be safely made to such institution." That language is immediately followed by the sound and economical home financial language. Similarly, in Section 6(i) the Act provides for expulsion of a member under three circumstances: (1) the member fails to comply with any provision of the Act; (2) the member is insolvent; or (3) the member has a management or home financing policy of a character inconsistent with sound and economical home financing or with the purposes of the Act.

Although it would not be entirely illogical to believe that the Bank Act established a lesser degree of financial impairment than insolvency as a ground for expulsion and used the sound and economical home financing language to accomplish this result, a better reading of the expulsion provision suggests that in using the sound and economical home financing language the Congress had in mind something other than financial solvency or soundness. Only this conclusion saves the sound and economical home financing language from being largely redundant. As pointed out in Section II.C.1. of this Opinion, it is a cardinal principle of statutory interpretation that the legislative body should be presumed to have inserted each part of a statute for a purpose, and no part should be presumed to be repetitious.

Accordingly, analysis of the statutory language is consistent with the OGC's argument that the sound and economical home financing language was included to protect borrowers from costly or perhaps other harmful lending practices.

(c) The Legislative History of the Bank Act.

The OGC's Brief includes quotations from the legislative history that concern the general purpose for which the Bank Act was enacted as well as one quotation from the little Congressional discussion that occurred concerning the meaning and purpose of the eligibility provision that contains the sound and economical home financing language. The legislative history suggests that the sound and economical home financing provision has multiple purposes. During floor debates on the Bank Act, Congressman Hancock (D. N. Carolina, and a member of the subcommittee of the Banking and Currency Committee to which the Bank Act bill was referred) stated:

> . . . The primary purpose behind this section [the eligibility criteria] is to set up a system which will be sound and permanent and which will foster the objectives of the bill—that is, adequate long-term credit facilities for home owners. For this reason, since the system is built upon member institutions it is important that only regulated and sound institutions be admitted. [75 Cong. Rec. 12609; *see* OGC Brief at 17.]

This statement implies that a purpose of the eligibility criteria was to exclude unregulated (i.e., irresponsible, or non-law abiding) associations. In the same statement, Congressman Hancock went on in a manner that suggests that one other purpose of the eligibility criteria was to ensure the financial stability of member associations:

> . . . For the safety of this system, it is important that only those institutions who can eco-

> nomically and safely make long term loans be admitted. . . . [*Id.*]

An indication that the Congress included the sound and economical home financing standard for the additional purpose of promoting consumer-oriented lending practices is found in an exchange between Senator Sheppard (D.Tex.) and Senator Watson (R.Ind.). In order to reject a claim that, other than a usury provision introduced by Congressman LaGuardia, there were no borrower safeguards in the bill, Senator Sheppard pointed to the eligibility safeguards in Section 4:

> I want to call attention to the last sentence of the first clause of Section 4 which reads as follows: No institution shall be eligible to become a member of or a non-member borrower of a federal home loan bank if . . . the character of its management or its home financing policy is inconsistent with sound and economical home financing, or with the purposes of this Act. [75 Cong. Rec. 14453.]

Senator Watson agreed with that interpretation and went on to emphasize that the eligibility criteria in Section 4 were intended to ensure that mortgage loan practices are protective of home borrowers:

> This is the savings clause; I have it underlined in the copy of the bill before me and had intended to read it. I will say to my friend from Texas, although I am delighted he has read it, because it gives absolute authority to prevent the loan shark from getting in his work. [75 Cong. Rec. 14453, 14454.]

In considering the Bank Act, some legislators opposed the addition of the usury provision contained

in the LaGuardia amendment on the grounds that it was unnecessary to further protect consumers since the bill *already* contained eligibility standards that adequately protected consumers from improper mortgage loan practices. A memorandum written by Congressman Reilly, the floor leader of the House bill, as quoted by Senator Robinson, stated:

> There is absolutely no necessity for Section 5 [the usury provision] in this bill, for the reason that Section 4 [the eligibility provision] and Section 9 [setting standards for advances by Federal Home Loan Banks to member associations] give the Federal loan board, the governing body created in this bill, complete authority to refuse the privileges of the home-loan bank to any home-mortgage organization that does not carry on a *legitimate and fair home mortgage business.*" [75 Cong. Rec. 14593 (emphasis added).]

The meaning of sound and economical home financing and the small body of legislative history that discusses the eligibility standard can be further understood by reference to the general purposes of the Bank Act. Canons of statutory interpretation direct that where, as here, the meaning of a specific provision is not fully established by the plain meaning of its language or its legislative history the provision should be read in light of the general purposes of the statute.[47] Although the OGC does not expressly say

---

[47] *See SEC* v. *C.M. Joiner Leasing Corp.*, 324 U.S. 345, 350-351 (1943):

> . . . courts will construe the details of an act in conformity with its dominating general purpose, will read text in light of context and will interpret the text so far as the words fairly permit so as to carry out in particular cases the generally expressed legislative policy.

so, it is presumably for this reason that the OGC's Brief contains numerous quotations from the Congressional debates concerning the Congress' general meaning and intent in enacting the Bank Act.

As noted earlier, the Bank Act's eligibility and expulsion formula expressly provides for denial of admission or expulsion where the character of an institution's management or its home financing policy is inconsistent with the "purposes of the Act." A "purpose of the Act" argument was *not* pleaded by the OGC and the analysis of the purposes of the Act in this Opinion is included only to shed light on the meaning of sound and economical home financing and not as a separate basis for our consideration of the OGC's claim that Gulf Federal is in violation of the Bank Act.

There is considerable material in the legislative history of the Bank Act, much of it quoted in the OGC's Brief, that indicates that one of the Congress' purposes in enacting the Bank Act was to relieve financial pressure on home loan borrowers by ensuring an adequate supply of long term mortgage money at attractive rates. For example, a House report on H.R. 12280, the bill that eventually became the Bank Act, emphasized that the bill would help the small home owner and relieve a situation where

> . . . [there] has never been sufficiently adequate [financing] to result in low costs of funds or sufficiently liberal loans to eliminate the costly second mortgage, land contract and other junior financing. . . .[48]

---

[48] Subcomm. of the House Comm. on Banking and Currency on H.R. 12280, H.R. Rep. No. 1418, 72d Cong., 1st Sess. 3 (1932). [hereinafter cited as Report No. 1418.]

The same report identifies fourteen purposes for the establishment of a Federal home loan bank system, ten of which relate to the availability or cost of mortgage money. For example, purpose number eight states:

> Funds for home owners should be available at low cost and in liberal amounts at all times. The home owner should not be subject to the vicissitudes of the general money market . . . . The home loan bank system will stabilize the home financing activities of the country. . . . [*Id.* at 10.]

In addition to assuring an adequate supply of long-term, low cost financing, the legislative history suggests that the Congress enacted the Bank Act for the related purpose of protecting home loan borrowers from improper charges and other damaging practices. Support for this interpretation comes from the inclusion in the final version of the Bank Act bill of an amendment introduced by Congressman LaGuardia. LaGuardia's amendment provided that no institution should be admitted to or retained in membership in the Federal home loan bank system if its interest rates are usurious, as defined in that section. The OGC's Brief includes a quotation from Congressman LaGuardia, wherein he argues that his interest ceiling amendment should be included in the bill in order to better protect the home owner:

> As I see and construe this bill, its sole and main purpose is for the relief of the home owner. We want to free the home owner from the clutches of the loan shark. [75 Cong. Rec. 12721; OGC Brief at 17.]

To the extent that Gulf Federal's loan practices improperly increase costs to home loan borrowers these practices appear to be inconsistent with sound and economical home financing. Indeed, the "improper cost argument" is the specific explanation given by the OGC as to how Gulf Federal's practices violate the Bank Act. The OGC's Brief states:

> Gulf Federal's practice of overcharging 444 borrowers five days' interest per year manifestly constitutes a violation of the 'sound and economical home financing' requirements of the Bank Act. *Clearly this practice is as much a device which increases the cost of carrying a loan* as does charging excessive interest, commissions, bonuses, membership fees and other activities which were discussed by the framers of the 1932 provisions. [OGC Brief at 18 (emphasis added).]

Another statement in the legislative history that suggests that the Congress intended to improve home loan practices generally (including presumably the elimination of a practice of violating the terms of loan agreements) is found in the thirteenth of the fourteen purposes of the Bank Act identified in the House report:

> It [the Bank Act] will stabilize these thrift home financing institutions; *will improve and standardize mortgage practices*; will decrease costs of mortgage money and will regulate the supply of mortgage credit in a way that will discourage building booms and support normal construction year-in-year-out. [Report No. 1418 at 10 (emphasis added).]

Concern for the security and protection of borrowers from improper lending practices is further indicated by a statement made by Congressman Hill during the House debates:

> It must be borne in mind at all times that the ultimate purpose of this legislation is to help the small home owner.
>
> * * * *
>
> If this great body of our citizenship is *placed on the basis of security in their homes* and are made self-sustaining in the maintenance of them and *are imbued with the feeling of security in their holdings*, their morale and courage will be strengthened and they will have a happier and more hopeful outlook on life. It is impossible to segregate the economic from the social conditions of a people." [75 Cong. Rec. 12606 (emphasis added).]

From this analysis it appears that the Congress enacted the Bank Act and established its sound and economical home financing standard in order to protect mortgage borrowers from short term, costly and other types of lending practices that are damaging to them.

(d) OGC's Bank Act Claim Is Aided By the Case Law.

This assessment of the OGC's claim that Gulf Federal's loan practices violate the Bank Act is consistent with the small body of relevant case law. There are no reported decisions that interpret the Bank Act's sound and economical home financing standard. A few decisions have reviewed the general purposes of the Bank Act. The most important is *Laurens Federal Savings and Loan Association* v. *South Carolina*

Tax Commission, 365 U.S. 517 (1961). In that decision the Supreme Court looked at the overall purpose of the Bank Act and ruled that a state tax on a savings and loan association's promissory notes executed in exchange for advances from its federal home loan bank violated the tax immunity provisions of the Bank Act and was inconsistent with the purposes of the Bank Act which, among other things, was to provide low cost mortgage money to home loan borrowers:

> It [the Act] set up a system of federally chartered Home Loan Banks for the purpose, as stated in the House and Senate Committee reports, of placing "long term funds in the hands of local institutions" in order to alleviate the pressing need of home owners for low cost, long-term installment mortgage money and to "decrease costs of mortgage money" with a "resulting benefit to home ownership in the form of lower costs and more liberal loans." [49]

This reading supports a generous construction of the Bank Act.

(e) Administrative Construction.

Although the Board has not heretofore dealt with the specific question at issue in this proceeding, the Board has previously construed the Bank Act and its sound and economical home financing standard in a fashion that supports the OGC's Bank Act claims. In 1972 the OGC issued a legal opinion that the Board has authority under the Bank Act to issue regulations prohibiting discriminatory lending practices by member associations:

---

[49] 365 U.S. at 522, *citing* Report No. 1418 at 8-10 & S. Rep. No. 837, 72d Cong., 1st Sess. at 9-11 (1932).

> From the legislative history of the [Bank] Act, and the language of the Act itself, it seems clear that Congress intended thorough-going Board supervision of member institutions with respect to their compliance with the purposes of the Act. This authority would appear to extend to regulation of discriminatory practices—even absent other laws specifically dealing with the subject.[50]

While the Board has never expressly adopted the above-quoted opinion, the Board has adopted the construction therein proposed by promulgating regulations aimed at eliminating discrimination in lending by institutions that are members of Federal Home Loan Banks. [12 C.F.R. Part 528 (1972).] These regulations cite Section 17 of the Bank Act [12 U.S.C. 1437.] (among other sources) as authority for the Board's issuance of the regulations. Section 17 gives the Board the "power to adopt, amend and require the observance of such rules, regulations and orders as shall be necessary from time to time in carrying out the purposes of the Act." The exercise of the Board's power to adopt those regulations was approved by the District Court in *Laufman* v. *Oakland Bldg. & Loan Co.*, 408 F.Supp. 489, 495 (S.D. Ohio 1976).

The adoption of the Board's "antidiscrimination" regulations in furtherance of the purposes of the Bank Act demonstrates the Board's view that the Bank Act requires that member associations adopt home lending programs that meet high standards of fairness,

---

[50] Memorandum from the OGC to the Office of Housing and Urban Affairs, "Civil Rights Authority and Responsibility of the Board" June 30, 1972 at 7. The memorandum noted that the legislative history indicates that the Congress intended the Board to have great discretion and control in regulating member associations.

equity and concern for the welware of borrowers.[51] Gulf Federal's practice of violating the interest calculation provisions of its home loan agreements with consequent increase in costs to borrowers manifestly cannot meet such a standard. Far from reflecting a concern for the welfare of its Borrowers, Gulf Federal's practice can only be viewed as evidencing a concern for increasing its own profits at the expense of its Borrowers. The ALJ cited cited the late Congressman Wright Patman as describing the use of the 365/360 day basis as "just plain old fashioned greed." [Recommended Decision at 20.] The instant case does not challenge the propriety of the use of the 365/360 day basis *per se*, but Gulf Federal's practice of using that basis in contravention of the terms of the 444 loan contracts cannot be expected to be viewed by the public much more charitably than Congressman Patman viewed the use of that basis itself.

(f) Conclusion: Gulf Federal Has Violated the Sound and Economical Home Financing Provisions of the Bank Act.

Taken together the statutory language, the legislative history, the case law and the administrative construction indicate that the "sound and economical home financing" standard in the Bank Act protects home loan borrowers from costly and improper lending practices. Gulf Federal's breach of the interest

[51] This Board's prior interpretation of the meaning of its governing statute would be accorded great weight by a court. *See Trafficante* v. *Metropolitan Life Insurance Co.*, 409 U.S. 205, 210 (1972); *Lewis* v. *Martin*, 397 U.S. 552, 559 (1970); *Red Lion Broadcasting Co., Inc.* v. *FCC*, 395 U.S. 367, 382 (1969).

provisions in the 444 loan contracts and the consequent and unexpected increase in charges to its borrowers is inconsistent with sound and economical home financing. Indeed, it is hard to conceive of improper lending practices, such as these, as being anything other than "unsound" and "uneconomical." Such practices have an improper and adverse impact on borrowers by being unjustly costly and creating unnecessary insecurity and concern. If such conduct were permitted throughout the system we have no doubt that the flow of mortgage money to consumers would be impaired and thus a primary and remedial purpose of the Bank Act would be frustrated. As indicated in connection with the Board's responsibilities under HOLA [see Section III.A. 4.(d). *supra*], public reaction to Gulf Federal's practice could have a detrimental effect on the Federal savings and loan system. Similarly a breach of public confidence in Gulf Federal and in the Board's willingness and ability to censure the propriety of Gulf Federal's dealings with consumers could compromise the effectiveness of the system established by the Bank Act.

In view of the foregoing and the principle of construction that remedial legislation should be liberally construed to achieve its remedial purposes,[82] we conclude that Gulf Federal has violated the sound and economical home financing provisions of the Bank Act. The appropriate remedy for this violation should be the subject of further briefing in accordance with the Board's views as discussed in Section III.A.5.(d). of its Opinion.

---

[82] *Fahey* v. *Mallonee*, 332 U.S. 245, 250 (1946); *Niagara Mohawk Power Corp.* v. *Federal Power Commission*, 379 F.2d 153, 158 (D.C. Cir. 1967).

C. *Does Gulf Federal's Practice Constitute a Violation of Federal Common Law?*

1. Positions of the Parties and the ALJ.

As a third ground for the issuance of a cease and desist order by the Board in this case, the OGC has alleged that Gulf Federal's practice constitutes a violation of Federal common law.[53] [Notice of Charges at 2.] This allegation is based on the language in Section 5(d)(2)(A) of HOLA authorizing the Board to issue a notice of charges and serve a cease and desist order:

---

[53] As defined in H. Hart & H. Wechsler, The Federal Courts and the Federal System (2d ed. 1973) at 770, "federal common law" is a term which refers "generally to federal rules of decision where the authority for a federal rule is not explicitly or clearly found in federal statutory or Constitutional command." For an explanation of the "federal" nature of the common law principles applied, Mr. Justice Jackson's concurring opinion in *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), is frequently cited:

> A federal court sitting in a non-diversity case . . . does not sit as a local tribunal. In some cases it may see fit for special reasons to give the law of a particular state highly persuasive or even controlling effect, but in the last analysis its decision turns upon the law of the United States, not that of any state. *Federal law is no judicial chameleon changing complexion to match that of each state wherein lawsuits happen to be commenced because of the accidents of service of process and of the application of the venue statutes. It is found in the federal Constitution, statutes, or common law. Federal common law implements the federal Constitution and statutes, and is conditioned by them.* Within these limits, federal courts are free to apply the traditional common law technique of decision and to draw upon all the sources of the common law in cases such as the present. [315 U.S. at 471-72 (footnote omitted) (emphasis added).]

> [i]f, in the opinion of the Board, an association is violating or has violated, or the Board has reasonable cause to believe that the association is about to violate, *a law*. . . . [emphasis added].

It should be noted that the term "a law" is broad enough to include violations of either Federal or state law. Since breach of contract is clearly a violation of the common law, the OGC could have alleged merely that Gulf Federal's practice constitutes a violation of common law, without specifying whether it is a breach of Federal or state law. However, the Notice of Charges specifically charges Gulf Federal with a violation of the *Federal* common law.

The OGC supports its contention by asserting, in substance, that:

(1) by virtue of the pervasive regulatory scheme enforced by the Board, Federal law "governs all aspects of the operations of Federal savings and loan associations" [OGC Brief at 25.], so that a breach of contract by Gulf Federal is necessarily a violation of Federal, rather than state, law, and

(2) by virtue of Regulation § 545.6-11, the Board has "fully occupied the field of loan contracts of Federal associations" [OGC Brief at 21.], and the Board has thereby made Federal law applicable to the interpretation and enforcement of such loan contracts.

Gulf Federal opposes the OGC's contention, arguing that the interpretation of the 444 loan contracts is a matter of state law and that therefore it cannot be said that a breach of those contracts is a violation of Federal common law. [Gulf Conclusions of Law,

No. 19.] The ALJ, while finding that Gulf Federal's practice of interest calculation constitutes 444 separate breaches of contract [Recommended Decision at 17.], concluded only that Gulf Federal's practice constitutes an unsafe and unsound practice within the meaning of the HOLA. The ALJ did not find whether there was a violation based on Federal common law.

2. The Board's Authority to Issue a Cease and Desist Order Extends to Violations of Common Law.

As a preliminary matter, it is clear that the Board's authority under Section 5(2)(d)(A) extends to violations of *common* law, as well as statutory law, irrespective of whether the law in question is Federal law or state law.

It is well established that the Board's enforcement authority under the federal regulatory scheme applicable to federal savings and loan associations embraces "fundamental principles of the common law consistent with policies of the regulatory scheme and necessary for their implementation." *Beverly Hills Savings and Loan Association* v. *FHLBB*, 371 F. Supp. 306, 314 (C.D. Cal. 1973). *Accord*, *Reich* v. *Webb*, 336 F.2d 153 (9th Cir. 1964), *cert. denied* 380 U.S. 915 (1965); *City Federal Savings and Loan Association* v. *Crowley*, 393 F. Supp. 644 (E.D. Wis. 1975); *Rettig* v. *Arlington Heights Federal Savings and Loan Association*, 405 F. Supp. 819 (N.D. Ill. 1975).

Hence, the reference to "a law" in Section 5(d)(2)(A) must be understood to encompass common law as well as statutory law. In *Beverly Hills*, *supra*, the court upheld the Board's authority under Section 5(d)(1) of HOLA to seek injunctive relief from an allegedly illegal transfer of control of a savings and

loan association on the theory that the transfer group breached its common law duty of good faith, even if their conduct did not violate any specific regulation of the Board. While the Board's authority in *Beverly Hills* was derived from language referring to violations of "any other law" in Section 5(d)(1), rather than the language of Section 5(d)(2)(A), the decision of the court makes clear that the Board's authority with respect to violations of law extends to violations of *common* law, saying:

> *the duties and responsibilities imposed* upon fiduciaries and those in positions of trust *by generally accepted and applied common law principles are implicit in the Act and the regulations promulgated thereunder* by the agency responsible for enforcement and implementation of the Act. [371 F. Supp. 306 at 314 (emphasis added).]

Since a breach of contract is a violation of common law, it is clearly encompassed within the Board's enforcement responsibilities under Section 5(d)(2)(A).

3. A Breach of Contract Is a Violation of Federal Common Law Principles Which Govern the Actions of Federal Associations.

The OGC argues that:

> an obligation [to comply with the clear and unambiguous terms of Gulf Federal's loan contracts] should . . . be found as a matter of Federal common law, which the courts must fashion in order to fill in any gaps which may exist in the [Board's] regulatory scheme. [OGC Brief at 22, 23.]

This conclusion is amply supported by the numerous decisions cited by the OGC in its brief [OGC Brief at 20.] which have recognized the Board's "cradle to grave" [54] regulatory power over Federal associations. As stated by the Wisconsin Supreme Court in *Kaski* v. *First Federal Savings and Loan Ass'n of Madison*, 240 N.W.2d 367 (Wis. 1976),

> The regulation of loan practices directly affects the internal management and operations of federal associations and therefore requires uniform control. [240 N.W.2d at 373.]

Accordingly, as stated by the court in *Murphy* v. *Colonial Federal Savings and Loan Association*, 388 F.2d 609, 612 (2d Cir. 1967), even state courts must apply Federal law when they "deal with the internal affairs" of Federal associations.

Thus, it appears clear that a breach of contract by a Federal savings and loan association constitutes a violation of Federal common law. To hold otherwise might subject HOLA, and other federal regulatory programs, to the "vagaries of the laws of the several states" [55] which could defeat the uniformity necessary to effectuate the Board's regulatory scheme. The importance of this uniformity was fully articulated in 1975 by the District Court decision in *Rettig* v. *Arlington Heights Federal Savings and Loan Ass'n*, *supra*:

> The consistency and universality inherent in applying a single federal standard to the federal

---

[54] *California* v. *Coast Federal Savings & Loan Ass'n*, 98 F. Supp. 311, 316 (S.D. Cal. 1951).

[55] *Clearfield Trust Co.* v. *United States*, 318 U.S. 363, 367 (1943).

savings and loan system, whether it be statutory, regulatory or derived from federal common law, is in keeping with the underlying objective of the HOLA, which contemplated a uniform set of policies for federally chartered associations which does not vary with quirks of local law. Even as a policy matter, it is clearly preferable to have federal law apply to the management practices of federally chartered associations.

Since only the Board may regulate or supervise the internal affairs of the defendant associations precluding any state interference and the fiduciary duties of directors and officers of federal savings and loan associations are matters relating to the internal affairs of the associations, *only federal law may be applied to questions involving them. This is true even where the directors' conduct is not specifically proscribed by any specific regulation of the Board. In such a case, the court may rely upon federal common law to fill out the framework of the Board's regulatory scheme.* [405 F.Supp. at 826 (citations omitted) (emphasis added).]

When a federal court or administrative agency has occasion to decide a question arising out of a congressional program, such as the regulatory scheme adopted in HOLA, the deciding body may resort to all the source materials of the common law, which includes reference to state court common law decisions. Nonetheless, the determination, when made, becomes a part of the Federal common law. It is that body of Federal common law that Gulf Federal violates when it breaches the 444 loan contracts. While the OGC uses this assertion, and the substantial body of law

which supports it [*Id.* at 23, 24.] in part to bolster its argument that Section 545.6-11 itself subjects Gulf Federal to the Federal common law, the OGC also argues that the Board's "pervasive regulatory scheme" imposes the Federal common law on Gulf Federal, even absent a specific regulation. [*Id.* at 25-27.] This argument is closely related to the OGC's argument that Federal common law exclusively governs the operations of Gulf Federal. [*Id.* at 19, 20.] Taken together, these arguments are persuasive.

Judicial decisions have established that a breach of contract involving a Federally chartered savings and loan association is cognizable under the Federal common law governing the internal management of federal savings and loan associations. *City Federal Savings and Loan Ass'n* v. *Crowley*, 393 F. Supp. 644 (E.D. Wis. 1975). In *City Federal*, the court refused to apply state law to breach of contract claims or to other claims involving breach of fiduciary duty, ruling instead that, given the Board's pervasive regulatory scheme which it felt governed the "internal affairs" of a Federal savings and loan association, the claims must be "deemed to arise under the federal common law. . . ." [393 F. Supp. at 657].

Accordingly, the Board finds that Gulf Federal's practice of using the 365/360 day basis of calculating interest on the 444 loan contracts constitutes a breach of the Federal common law. The appropriate remedy for this violation should be the subject of further briefing in accordance with the Board's views as discussed in Section III.A.5.(d). of this Opinion.

Since the Board finds persuasive the OGC's argument that by virtue of the pervasive regulatory scheme governing the operations of Federal savings and loan associations, a breach of contract is a violation of

Federal common law, the Board does not find it necessary to treat the OGC's other argument that Section 545.6-11 of the Board's Federal Regulations, standing alone, makes Federal law applicable to the interpretation and enforcement of loan contracts of Federal associations.

IV. OTHER EXCEPTIONS BY THE PARTIES.

Except insofar as the parties' Exceptions are specifically addressed in this Opinion and except insofar as the parties' Exceptions relate to the remedy which will be considered in a subsequent opinion, the Board, after careful consideration (1) accepts the OGC's Exceptions as being accurate, factual corrections and (ii) rejects Gulf Federal's Exceptions as either immaterial to the Board's resolution of the matter or inconsistent with the findings of fact and conclusions of law contained in this Opinion.

By THE FEDERAL HOME LOAN BANK BOARD

/s/ Ronald A. Snider
RONALD A. SNIDER
Assistant Secretary

Date: December 15, 1977

APPENDIX E

OPINION OF THE FEDERAL HOME LOAN BANK BOARD

I. BACKGROUND:

A. *Procedural Background*

This case is before the Federal Home Loan Bank Board (the "Board") for a final opinion and order regarding the remedial action (if any) which the Board might require to be taken by Gulf Federal Savings and Loan Association of Jefferson Parish, Metairie, Louisiana ("Gulf Federal") pursuant to the Board's authority under Section 5(d)(2)(A) of the Home Owners' Loan Act of 1933, as amended [12 U.S.C. 1464(d)(2)(A)] ("HOLA"). In an opinion of the Board, dated December 15, 1977 (the "Board Opinion"), the Board found that Gulf Federal has engaged in an unsafe or unsound practice within the meaning of Section 5(d)(2)(A) of HOLA, and that Gulf Federal has violated the "sound and economical home financing" provisions of the Federal Home Loan Bank Act [12 U.S.C. 1424(a), 1426(i)] (the "Bank Act") and the Federal common law by charging interest on some 444 mortgage loans at a rate greater than that specified in the contractual agreements with the borrowers under those loans (the "Borrowers"). Reference is made to the Board Opinion for further background on this case and for the reasons underlying the Board's Opinion.

On December 18, 1977, the Board issued an Order (the "December 18 Order") adopting the Board Opinion and ordering Gulf Federal and the Office of General Counsel of the Board (the OGC") to respond in writing to a series of questions, posed in

the December 18 Order, pertaining to the remedy of restitution, which the Board could impose against Gulf Federal. On March 15, 1978, the OGC filed a Response to the Questions Raised in the December 18 Order (the "OGC Response"), and on March 17, 1978, Gulf Federal filed a Qualified Response to the December 18 Order (the "Gulf Federal Response").

On April 17, 1978, the Board issued an Order directing that a hearing be held on May 5, 1978, on the subject of the issues which were still to be determined by the Board (the "May 5 Hearing"). On April 24, 1978, Gulf Federal submitted a Motion for Presentation of Documents at Oral Hearing, which sought the admission into evidence of certain Acts of Correction which Gulf Federal was in the process of soliciting from its Borrowers. (A sample Act of Correction is attached as Exhibit 1.) Gulf Federal renewed its Motion at the May 5 Hearing and offered 103 executed Acts of Correction to be introduced into evidence. This motion was opposed by the OGC. The Board granted Gulf Federal's Motion, admitting the 103 Acts of Correction into evidence. However, the Board specifically noted that it was making no ruling as to the nature, propriety or effect of those Acts of Correction.

B. *The Issues To Be Decided*

The Board Opinion found[1] that Gulf Federal's practice of calculating and charging interest on the 444 disputed loan contracts on the basis of the 365/360 day interest tables constituted a breach of the following provision, which was contained in each of those loan contracts:

---

[1] *Board Opinion* at 16, 27.

> "All interest is to be calculated monthly on the basis of a 365-day calendar year, and charged for each day of the month, on any balance of the principal sum remaining due and unpaid. . . ."

In so finding, the Board found that Gulf Federal's breach of the 444 loan contracts resulted in excessive interest equal to five days or 1/72 of the face rate of interest being charged to the Borrowers under each of those contracts.[2] The amount of the excessive interest charged to each Borrower on each payment of interest could be calculated by multiplying 1/72 or .0139 by the annual interest rate and multiplying that quantity by the outstanding principal on the loan. Based on data supplied by Gulf Federal, the Board's Office of Economic Research has calculated the aggregate amount of overcharges to Borrowers as being $90,605.[3] Gulf Federal has not disputed these calculations, either in the Gulf Federal Response or at the May 5 Hearing.

The Board Opinion also found that Gulf Federal's practice constituted an unsafe and unsound practice under Section (5)(d)(2)(A) of HOLA, had violated the "sound and economical home financing" provisions of the Bank Act, and had violated the Federal common law.[4] Accordingly the Board concluded that it had the authority under Section (5)(d)(2)(A) of HOLA to issue a cease and desist order requiring affirmative corrective action by Gulf Federal.[5] The Board Opinion indicated that the corrective action

---

[2] *Id.* at 5.

[3] OGC Response at 4.

[4] Board Opinion at 62, 95 and 102.

[5] *Id.* at 64, 70.

to be required by the Board could include restitution by Gulf Federal of the excess interest charged. However, due to the limited information contained in the record on the question of remedies, the Board did not decide the issue of what corrective action, if any, Gulf Federal should be required to take pursuant to the Board's final order in this proceeding. That issue is the sole issue remaining to be decided in this Opinion.

II. THE CHOICES OF REMEDIES AVAILABLE TO THE BOARD

A. *Restitution*

(1) *The Views of the Parties*

The OGC recommended in the OGC Response that the Board require Gulf Federal to make restitution to the affected Borrowers [6] by means of (1) a lump sum repayment of all excessive interest charged to Borrowers whose loans have been fully paid or assumed; and (2) an adjustment on Gulf Federal's books of the principal balances of all of the loan contracts which remain outstanding. The OGC recommended this bifurcated approach because of its conclusion that, while Gulf Federal charged interest on its books on the basis of the 365/360 day interest tables, it properly fixed the Borrowers' principal and

[6] The OGC has concluded that of the 444 loan contracts considered in the Board Opinion, only 413 require corrective action. The remaining 31 loans were home improvement loans which involved notes that made no mention of the method of calculating interest. [OGC Response at 3.] The OGC feels, and the Board agrees, that it would be improper to require Gulf Federal to make restitution as to those 31 loans.

interest payment schedules in accordance with the 365/365 day interest tables. [OGC Response at 5.] As a result, excessive interest was charged to all of the Borrowers' accounts, but Borrowers did not actually make excessive payments until their loans were paid off or assumed.[7] Accordingly, the OGC contends that

---

[7] Technically, Borrowers whose loans were assumed did not make excessive payments to Gulf Federal. However, because of Gulf Federal's practice of charging interest on its books on a 365/360 day basis, Gulf Federal used too much of each payment to pay interest and used too little of each payment to reduce principal. Consequently, when loans were assumed, as well as when loans were paid off, the principal balances shown on Gulf Federal's books were too high. This meant that if a loan was assumed by the purchaser of Borrower's home, the person assuming the loan agreed to assume a larger loan than he should have been assuming. Consequently, he gave too small a portion of the purchase price to the Borrower in cash. Similarly, if the Borrower sold his home and used the proceeds to pay off the loan, he retained too small a portion of the purchase price in cash. Thus, the net effect of Gulf Federal's practice was the same on those Borrowers whose loans were assumed as on those whose loans were paid off.

This may be illustrated by an example. If during the first several years of a $50,000 loan, Gulf Federal improperly attributed only $4,000 to the reduction of principal, instead of $5,000, the principal balance shown on Gulf Federal's books would have been $46,000 rather than $45,000. A person who purchased the Borrower's home for $70,000, and who assumed the loan, would have been advised that he was assuming a $46,000 loan. Accordingly, he would have paid the Borrower only $24,000 in cash. If the books had shown the proper balance of $45,000, he would have paid the Borrower $25,000 in cash. Hence, the Borrower would have received $1,000 less for the equity in his home than he should have. The Borrower would have received the identical amount for the equity in his home if he had received $70,000 from a non-assuming

> "adjustment of Gulf Federal's principal balances is all that is necessary to effectuate corrective action with respect to loans which are still in force." [OGC Response at 5.]

After consultation with the Board's Office of Examination and Supervision, the OGC recommends that Gulf Federal make such adjustments by "a debit to nonoperating expense and separate credits to the various subsidiary loan accounts." [*Id.* at 7.] The OGC states that this approach is an accounting adjustment only and would not affect Gulf Federal's cash flow. [*Id.*]

As to those loans which have been paid off or assumed,[8] the OGC believes that Gulf Federal should make restitution by means of a lump sum cash payment equal to the amount of interest overcharged. [*Id.* at 5, 8.] The OGC has calculated that the amount of these overcharges is $29,335 as of December 31, 1977. [*Id.* at 4.] In the judgment of the OGC, such a cash repayment would not have an unduly adverse effect on Gulf Federal's financial petition. [*Id.* at 8.]

---

purchaser and had paid off the loan with the proceeds. If the principal balance was shown as $46,000 instead of $45,000, he would have retained $1,000 less than he should have. Thus, Borrowers whose loans were assumed suffered the same loss as a result of Gulf Federal's practice as did Borrowers whose loans were paid off.

[8] Although the OGC believes that lump sum payments should be made to Borrowers whose loans have been assumed, it follows that principal adjustments should also be made on such loans for the period following the assumption. Such adjustments would correct any excessive interest charges which have been charged on Gulf Federal's books since the assumption but which would not be refunded to Borrowers by means of a cash repayment.

In addition to recommending that Gulf Federal make a cash repayment of overcharges to the Borrowers under loans which have been paid or assumed, the OGC urges that Gulf Federal be required to pay interest on those overcharges at the rate of 7% per annum. [*Id.* at 4, 8, 9.] The OGC argues that the Board has the authority to require such interest and that such a requirement is necessary to "effectuate the Board's remedial objectives." [*Id.* at 17.]

Gulf Federal has made little substantive response to the Board's request for further briefing on the subject of restitution. The Gulf Federal Response contains little other than the assertion that "[r]estitution should not be made nor should interest be due because there has been no overcharge." [Gulf Federal Response at 2.] Since the Board Opinion contained a final decision by the Board that there has been an overcharge, the assertion contained in the Gulf Response is less than compelling.

At the May 5 Hearing, Gulf Federal elaborated on its views to the extent of saying, in effect, that all possible forms of restitution are equally unacceptable to Gulf Federal. Counsel for Gulf Federal stated:

> "There are numerous methods of refund. We could discuss those. They are rather clear-cut. It's been suggested by General Counsel that the assumptions or the paid-out loans, there should be a direct payment, there should be a credit against principal for those which are on-going, and, we simply don't see where it makes any real difference. It's all going to impact the savings and loan in the same way." [Hearing Tr. at 31.]

In addition to the foregoing, Gulf Federal opposes the recommendation by the OGC that Gulf Federal be required to pay interest on the amount of its over-

charges. Gulf Federal challenges the Board's authority to require such interest, arguing that such a requirement would be contrary to Louisiana law. [*Id.*]

(2) *Analysis*

The Board has reviewed the data submitted by the OGC together with the OGC Response. The data included calculations by the OGC and computer printouts, which together constitute an analysis of the amount of excessive interest charged by Gulf Federal on each of the loan contracts and an analysis of Gulf Federal's financial position. Gulf Federal has not challenged or contradicted the OGC's data. Gulf Federal indicated at the May 5 Hearing, that it had not checked the OGC's calculations,[9] but Gulf Federal did not submit any data of its own. The Board adopts the data submitted by the OGC as establishing the amount of excess interest charged on each loan, as of December 31, 1977, and the financial position of Gulf Federal during the period covered by the data. The Board further adopts the method employed by the OGC in computing the amount of excess interest charged.

The Board has considered the views of both parties and has decided that, insofar as restitution is required under this Opinion, the Board will accept the recommendations of the OGC with respect to the lump sum repayment of excess interest and with respect

---

[9] Counsel for Gulf Federal stated: "With respect to the calculations that have previously been made, we have not had a chance—we hope not to have to check each and every one of these calculations. A couple of them have not come out exactly right to the S and L, and therefore we don't want to stipulate that the calculations are correct." [Hearing Tr. at 30, 31.]

to the adjustment of principal balance on Gulf Federal's books. This approach appears to be fair to the affected Borrowers, who will receive full restitution,[10] and to Gulf Federal, which will not suffer any undue financial hardship.

In this regard, it should be noted that Gulf Federal suggested at the May 5 Hearing that any requirement of restitution will have an adverse financial impact on Gulf Federal. [See, Hearing Tr. at 25, 32.] Mr. Mmahat, President of Gulf Federal, stated that Gulf Federal may fail to meet its net worth requirements in 1978 and that without the "excess money" resulting from interest overcharges, "Gulf Federal is not going to be in a strong financial position . . . . " [*Id.* at 25.] The OGC's data and analysis, however, indicate that, based on Gulf Federal's 1977 financials (which, the OGC emphasized, are the only financial statements the Board has to go by [*Id.* at 37]), Gulf Federal will not be unduly harmed by returning interest overcharges to the affected Borrowers. Naturally, Gulf Federal will not be in as "strong" a financial position without this "excess money" as it would be with it. This does not, however, provide the Board with a basis for allowing it to keep interest that was improperly collected.

However, the Board does not accept the recommendation of the OGC that Gulf Federal be required to pay interest on the sums repaid to Borrowers.

---

[10] The restitution received by the affected Borrowers will be a refund of interest improperly paid. This refund may have income tax consequences for the affected Borrowers, particularly for those who took itemized deductions for interest payments during the term of their loans. The Association should consider any responsibility it may have to alert Borrowers to this possibility.

The Board finds that it has the authority to impose such interest. The basis for this authority is well stated in the OGC Response. However, the Board notes that the amount of interest involved in this case is extremely small.[11] Based on the fact that this is a case of first impression for the Board, and that the costs of calculating and administering the return of such a small amount may be disproportionate to the amount paid to Borrowers, it does not appear appropriate to the Board for it to exercise its authority to require payment of interest on the sums repaid in this case. The Board emphasizes that this decision regarding interest is limited to the facts of this particular case and that it may order payment of interest in any similar cases in the future.

B. *The Acts of Correction Proffered by Gulf Federal*

(1) *The Views of the Parties*

Gulf Federal has introduced into evidence 103 executed Acts of Correction and has asked the Board to grant it 180 days in which to obtain the execution of such Acts for the remainder of the 444 loan contracts. These Acts of Correction recite that "an error was committed in preparing" the underlying Act of Mortgage "in that the method of computing interest was not correctly described and does not reflect the agreement of the parties . . . ." The Acts of Correction set forth the disputed provision in the loan contracts and state that "it was the intention of the parties" that that provision read:

> " 'All interest is to be calculated monthly by use of the three hundred and sixty (360) day in-

[11] OGC Response at 4.

> terest tables, and charged for each day in the month, on any balance of the principal sum remaining due and unpaid; . . .' "

After a further recitation pertaining to the interpretation of the Board,[12] the parties agree "to reform and correct" the disputed provision to read as stated above. The consideration for this agreement is "the same consideration originally received." In addition to an agreement to so "reform and correct" the loan contracts, the Acts of Correction state that the parties

> "acknowledge that the interest herein has been computed from the inception of this loan under the language as corrected herein and the parties hereto intend that the correction herein be retroactive to the original date of the loan."

Gulf Federal has contended throughout these proceedings that the disputed provision in the 444 loan contracts is a mistake and does not reflect the true intentions of the parties. Gulf Federal argued at the May 5 Hearing that the proffered Acts of Correction are "appropriate" documents with which to reform the 444 loan contracts in order to correct the mistake and bring the contract language into accord with the parties' intentions. According to counsel for Gulf Federal:

> "If [in] their mortgage loan document, the wrong number, or street, [or] lot number is given, one enters into an Act of Correction, and the parties agree for the consideration of the original Act that what they intended was to say

---

[12] See *infra*, at 12.

> lot three instead of lot four, and an Act of Correction is entered into." [Hearing Tr. at 9].

It is the contention of Gulf Federal that the execution of the proffered Acts of Correction by all of the Borrowers would make the "refund question moot." [Hearing Tr. at 11.] Gulf Federal observes that, if it is permitted to obtain the execution of the Acts of Correction instead of being required to refund any monies to its Borrowers, there will be no adverse financial consequences on Gulf Federal. [*Id.*] It argues further that this will also have the least adverse impact on Gulf Federal's standing in the community. [*Id.*] Accordingly, Gulf Federal urges that it be permitted to obtain the execution of the proffered Acts of Correction for all of the 444 loans, and that such execution be the sole corrective action required by the Board in its final order.

The OGC has not argued that the execution of Acts of Correction, or some similar document, by all of the Borrowers under the 444 loan contracts would be an inappropriate or inadequate remedy. However, the OGC has raised questions as to the adequacy of the disclosure made to Borrowers by Gulf Federal, either collaterally or in the proffered Acts of Correction themselves. The OGC stated at the May 5 Hearing that it

> "would not oppose the attempt of the Association to obtain these Acts of Correction, as long as the Association made a full and fair disclosure to all of the [B]orrowers . . . ." [Hearing Tr. at 16.]

The nature of the disclosure to be made to the Borrowers was described by the OGC as follows:

> "We believe that disclosures should be made of the existence of the [Board] proceedings, the fact that a violation of these loan contracts had been determined in administrative proceedings by the Bank Board, that in effect these [B]orrowers have been over-charged according to the terms of their loan contracts and the individual amount of each overcharge should be disclosed to each particular [B]orrower, as well as the method of repayment or adjustment that would be appropriate in connection with each particular loan, depending on whether it's a loan which is still on the books or whether it is a loan that has been paid off." [*Id.* at 40, 41.]

The OGC suggests that evidence of such disclosure could be contained in affidavits executed by each Borrower executing an Act of Correction. [*Id.* at 16, 23.] The OGC reasons that the Board should not force a Borrower to take money owed to him if "after knowing all the facts, without any coercion, in the freedom of his own choice, [he] decides not to take the money . . . ." [*Id.* at 23.] In the absence of such evidence of disclosure, however, OGC would not agree to the execution of the Acts of Correction as a substitute for restitution to the Borrowers of the excessive interest charged.

Gulf Federal believes that the proffered Acts of Correction, taken alone, provide sufficient information to the executing Borrowers, and that no further disclosures ought to be required. To support its view, Gulf Federal points to the following language contained in the Acts of Correction:

> "If the Interpretation that the Federal Home Loan Bank Board has given to the language as contained in the act being corrected herein is

> imposed upon the parties then the interest charged would be 1/72nd of each per cent lower than the interest actually charged on your loan."

At the May 5 Hearing, counsel for Gulf Federal argued that

> "these Acts [of Correction] speak for themselves. We don't need to go into disclosure beyond what the Act [of Correction] says. It only says what it says, and no more." [*Id.* at 24.]

In this regard Gulf Federal emphasizes its view that the Acts of Correction should not be seen as a decision by the Borrowers not to take money to which they are entitled, but rather as an affirmation by the Borrowers that the language of the 444 loan contracts did not say what both parties originally intended and a willingness to correct that faulty language. Again, as stated by counsel to Gulf Federal at this May 5 Hearing:

> "It is not the people saying keep a hundred dollars or keep $94. They're saying there was a mistake in the Act [of Mortgage], and they're willing to correct it. They've got the mortgage, the consideration was there, and they're correcting the language of the Act [of Mortgage]." [*Id.* at 23.]

(2) *Analysis*

There is no dispute between Gulf Federal and the OGC that, at least if proper disclosures are made to the Borrowers, the execution of an Act of Correction, or some similar document, by each of the Borrowers under the loan contracts would constitute adequate corrective action in this matter. In this the Board

agrees.[13] While the Board has concluded that the disputed provision in the loan contracts cannot be interpreted to permit Gulf Federal to calculate interest on those loans on the basis of the 365/360 day interest tables, and that Gulf Federal's practice of so calculating the interest constituted a breach of each of the loan contracts, the Board has no reason to insist that Gulf Federal perform all of those contracts in strict accordance with their terms if the parties to those contracts do not wish it. Similarly, even as to those loan contracts which have been fully performed, if the Borrowers under each such contract are prepared to attest that the contract was performed in accordance with their understanding of its terms and that they do not wish to receive repayment of those sums which would be due them if the contract were to be enforced according to its literal terms, this Board has no reason to insist that restitution be made to those Borrowers. Indeed, the approach which Gulf Federal has presented to the Board is commendable in that it provides an alternative to restitution which, if tailored to the needs of the particular matter, may be useful in other proceedings as well as in this one.

(a) *The Interest of the Board*

In each case, however, the matter of the Borrowers' thorough understanding of the significance of their actions is of the utmost importance. This Board can-

---

[13] The Board makes no finding as to the appropriateness under local practice of an Act of Correction to modify the loan contracts here in question. Counsel for Gulf Federal has stated that it is the proper form and the Board has no reason, other than that suggested in the text below (see *infra*, at 19-20), to question that statement.

not acquiesce to "corrective" action which may have the effect of perpetuating, rather than ameliorating, the unsafe and unsound practice in which the Board has found Gulf Federal to have engaged.

It is important to emphasize, in this connection, that the Board's concern in this proceeding is regulatory. The Board is concerned with the adequacy of the corrective actions taken by Gulf Federal in order to eliminate the potentially harmful effects of an unsafe and unsound practice under Section 5(d)(2)(A) of HOLA and of a violation of the sound and economical home financing provisions of the Bank Act, as well as of numerous violations of the Federal common law. Hence, the Board's judgment as to the adequacy of the proffered Acts of Correction as a remedy for Gulf Federal's breaches of contract must involve consideration of more factors than might be considered by a Federal or state court sitting in judgment of a breach of contract claim brought by one of the affected Borrowers.

(b) *Adequate Disclosure*

Thus, the issue is not whether, under local practice, the proffered Acts of Correction would be an appropriate means of reforming the loan contracts and eliminating any potential breach of contract claims. As indicated by Chairman McKinney at the May 5 Hearing, the issues in this case "require the balancing of interest[s] and the need to bear certain distinctions in mind." [Hearing Tr. at 5.] In this regard, Chairman McKinney emphasized,

> "The Board must distinguish between arguments that might legally excuse the Association and arguments that might mitigate any remedies in this case." [*Id.*]

Nevertheless, it seems appropriate for the Board to take notice of the fact that the issue of adequate disclosure to the Borrowers—the issue which constitutes the primary disagreement between Gulf Federal and the OGC at this stage of the proceedings—would be pertinent in a civil breach of contract proceeding, just as it is pertinent here.

Under commonly accepted principles of law, a contract cannot be validly amended without an adequate meeting of the minds of the parties to the contract. This rule is equally well established in Louisiana as elsewhere. As stated by the court in *Tharpe* v. *Tracy*, 40 So. 2d 509 (1949), the rule established in Louisiana Civil Code Article 1945 that there can be no contract without the common consent of the parties is "equally applicable to the construction of agreements abrogating or modifying contracts." [40 So. 2d at 511.] Article 1819 of the Louisiana Civil Code expands upon the concept of common consent, providing that:

> "Consent being the concurrence of intention in two or more persons, with regard to a matter understood by all, reciprocally communicated, and resulting in each party from a free and deliberate exercise of the will, it follows that there is no consent, not only where the intent has not been mutually communicated or implied, as is provided in the preceding paragraph, but also where it has been produced by—Error; Fraud; Violence; Threats."

Thus, "error" can negate apparent consent, and under Louisiana law, as under other bodies of American law, error may include "error of fact, which proceeds either from ignorance of that which really exists, or from a mistaken belief in the existence of

that which has none [i.e. that which does not exist]." [La. Civ. Code Art. 1821; *cf.*, *id.* Arts 1823 and 1825.] As stated by the Louisiana Supreme Court in *Pan American Production Co.* v. *Robichaux*, 200 La. 666, 8 So. 2d 635 (1942),

> "legal consent is an act unclouded by error or mistake. Consent is vitiated by error. Consent produced by error of fact is not legal consent." [40 So.2d at 639.]

[See also, *Calhoun* v. *Teal*, 106 La. 47, 30 So. 288 (1901).]

Thus, even if this Board were concerned merely with the binding nature of the proffered Acts of Correction, the Board would be obliged to use its best efforts to assure that the Borrowers did not execute such Acts as a result of an error of fact. This is of particular importance in a case, such as the instant one, in which one party is seeking to avoid a possible monetary loss by entering into a contract modification. It is essential that the Borrowers understand the facts motivating Gulf Federal to seek the modification. As suggested by the case of *Cole* v. *Lumbermens Mutual Casualty Company*, 160 So.2d 785 (La. App. 1964), obtaining the execution of the Acts of Correction under such circumstances might amount to civil fraud.

In *Cole*, the plaintiff had entered into a compromise release as a result of an error of fact as to the insurance coverage available. That error had been known to the insurer to be the sole reason for the agreements, and the insurer had induced the consent of the plaintiff on the basis of this error. The court held that there was no consent, and therefore no valid contract. In reaching this conclusion, the court

quoted extensively from the Louisiana Civil Code provisions defining fraud:

> "Finally, and most pertinently here, 'In all cases, however, when the information which would have destroyed the error [as to the motive, or principal cause], has been withheld by the other party to the contract, it comes under the head of fraud, and invalidates the contract.' LSA-C.C. Art. 1832.
>
> LSA-Civil Code Article 1847 further defines fraud as applied to contracts, as 'the cause of an error bearing on a material part of the contract, created or continued by artifice, with design to obtain some unjust advantages to the one party, or to cause an inconvenience or loss to the other.' " [160 So.2d at 788.]

This is not to say that Gulf Federal has engaged or would engage in fraud or deception. The Board makes no finding on this point. The foregoing, however, makes clear that the Board must be concerned with the quality of disclosures made to Borrowers in connection with Gulf Federal's efforts to obtain execution of Acts of Correction.

The Board does not believe that the language of the proffered Acts of Correction is adequate to provide the disclosure to Borrowers necessary in this proceeding. The proffered Acts offer little, if any, intelligible information to Borrowers about these proceedings, the findings of the Board or, most importantly, the very real possibility that persons not executing an Act of Correction will be entitled to cash refunds or to credits to the principal balances of their outstanding loans. Without meaningful disclosure of these facts, it is not clear that the Borrowers who execute them

will understand the significance or impact of their actions. Absent such an understanding it is questionable whether, as a legal matter, the Borrowers could be said to have consented to the contract modifications contained in the Acts of Correction and, therefore, whether the modifications would be enforceable.

Apart from considerations of enforceability, however, the Board believes that further disclosure is required in order to satisfy the regulatory purposes of the Board. As emphasized earlier, the Board must be confident that the improper practices engaged in Gulf Federal are being corrected, not perpetuated, by the execution of Acts of Correction.

(c) *Adequate Consideration—Fully Paid Loans*

One other matter of contract law must be of concern to the Board. Counsel for Gulf Federal has stated that in Louisiana, an Act of Correction is the appropriate form of document for remedying an erroneous provision in a mortgage loan contract, such as a "wrong number or street, or lot number." [Hearing Tr. at 9.] The Board takes notice of the fact that Acts of Correction are a form of instrument used in Louisiana to correct at least some erroneous statements in notarial acts. [See, *Giuffria Realty Co.* v. *Kathman-Landry, Inc.*, 173 So.2d 329 (La. App. 1965).] The Board has no reason to question the appropriateness under local practice of Acts of Correction to effect the modifications to loan contracts that are suggested by Gulf Federal, insofar as they apply to loans which are still outstanding. However, the Board is concerned that an Act of Correction may be of dubious legal effect if executed by the parties to a mortgage loan contract after the loan has

been fully paid, the mortgage released of record and the contract, in effect, extinguished.[14]

Under such circumstances the notarial act being "corrected would no longer appear to have any legal existence. This is in contrast to a correction of a deed or other instrument which has continuing legal significance, in that it establishes a claim of title, even though the underling contract has been fully performed.

As applied to those loan contracts which have been fully paid, the proffered Acts of Correction appear to be less analogous to reformations of contract than to releases or waivers of claims or causes of action. Yet, while the proffered Acts of Correction, according to Gulf Federal, are given "for the consideration of the original Act [of Mortgage]" [Hearing Tr. at 9], both Federal and Louisiana law require that a release or waiver must be given for current consideration in order to be binding. As stated by the court in *Bielkiewicz* v. *Rudisill*, 201 So.2d 136 (La. App. 1967),

> "A unilateral 'release' whereby without any shown consideration one party receives nothing in exchange for the release of his claim, simply does not meet the legal requirements of a valid compromise which is res judicata between the parties . . . ." [201 So.2d at 141].

[See also, *Inland Empire Builders, Inc.* v. *United States*, 424 F.2d 1370, 1375 (Ct. Cl. 1970) ("a valid release must be supported by consideration"); *Pac-*

---

[14] Gulf Federal has stated its intention to obtain the execution of Acts of Correction for all of the 444 loan contracts, including those which have been paid in full. [Hearing Tr. at 52.] Under La. Civil Code Art. 2130, "Obligations are extinguished: By payment. . . ."

con, Inc. v. *United States*, 399 F.2d 162 (Ct. Cl. 1968); *Hyatt* v. *Hartford Accident and Indemnity Co.*, 225 So. 2d 102 (La. App. 1969); *Green* v. *Nat'l Life & Accident Ins. Co.*, 183 So. 604 (La. App. 1938).]

Thus, it is possible that the execution of Acts of Correction by Borrowers whose loan contracts have been fully performed may not be legally sufficient to release Gulf Federal from civil liability for excess interest charges. In *Dale* v. *Nassar*, 240 So.2d 775 (La. App. 1970), a homeowner who signed a release, without consideration, purporting to release a contractor from liability under a home improvement contract was not barred from suing for breach of contract. In order to protect against this possibility, the proffered Acts of Correction would have to be modified to reflect some current consideration before executions of such documents are solicited from Borrowers whose loans have been fully paid, or else restructured so as to eliminate the possible problem presented by the lack of consideration. Whether the Acts of Correction can be restructured in a manner sufficient to create an estoppel against those Borrowers, and to evidence the agreement of those Borrowers that their loan contracts were performed in accordance with their understanding of their original terms, or whether an entirely different form of document is necessary to accomplish these purposes, are questions which the Board believes should be decided in accordance with Louisiana law.

CONCLUSIONS

Based upon the foregoing, the Board concludes that the execution of Acts of Correction, or similar documents adequate to evidence the agreement by the affected Borrowers that the loan contracts have been or

are being performed in accordance with their wishes and understanding, coupled with full disclosure of the pertinent facts of these proceedings as set forth in this Opinion, will constitute satisfactory corrective action by Gulf Federal. Evidence of the necessary disclosures shall be contained in an affidavit (or some other type of document(as appropriate under Louisiana law), executed by the Borrower, and shall be obtained at the same time as the execution of the Act of Correction or similar document. Affidavits shall also be obtained from Borrowers who have already executed Acts of Correction.

Gulf Federal and the OGC are directed to seek agreement upon the form of all of these documents on or before July 14, 1978. However, the Board does require that each such affidavit state that the Borrower is aware: (1) of the existence of these proceedings; (2) that the Board has determined that Gulf Federal's practice of calculating interest on the Borrower's loan on the basis of the 365/360 day interest tables constitutes a breach of the Borrower's loan contract; (3) that the effect of that breach has been that Gulf Federal has charged the Borrower more interest than was permitted under the loan contracts; (4) of the amount which the Board has determined to have been overcharged to the Borrower; and (5) that by executing the Act of Correction the Borrower is giving up the rights to recover the amount which the Board has determined has been overcharged, plus overcharges subsequent to the Board's computation.

Gulf Federal may solicit the execution of such documents after they have been approved by the OGC and until October 16, 1978. Gulf Federal shall make restitution to all Borrowers who have not executed such documents by that date. Such restitution shall

be in accordance with this Opinion, shall be as of the date of such restitution and computed in accordance with the method employed by the OGC in its response to the Board's December 18 Order, and shall be completed no later than October 31, 1978. Such restitution shall take the form of (1) and adjustment by Gulf Federal on its books of the outstanding principal balance of those loans which have not been paid off, and (b) a lump sum repayment of excess interest charged to those Borrowers whose loans have either been paid off or assumed. In making such restitution, Gulf Federal shall give written notice to each Borrower to whom restitution is made: (1) that excessive interest has been charged to the Borrower; (2) that the improper charges are being corrected; and (3) of the means—either a lump sum repayment or an adjustment to the principal balance—being utilized to correct those charges on that Borrower's loan.

In conjunction with making the restitution described above, Gulf Federal shall cease and desist from calculating interest on its loan contracts in a manner inconsistent with those contracts, and shall specifically cease and desist from calculating interest on the 365/360 basis as to all loans as to which restitution is required. Gulf Federal shall cease and desist from using the 365/360 method as of the date restitution is made to a particular Borrower, but in no event later than October 31, 1978. In addition, Gulf Federal shall begin using the 365/365 method of calculating interest immediately upon cessation of use of the 365/360 method.

Since 31 of the 444 loan contracts which have been the subject of this proceeding do not contain the disputed provision on the calculation of interest [see, *supra* n.6], the Board finds that corrective action in

accordance with this Opinion is necessary only with respect to the 413 loans involving that disputed provision.

All contacts with Borrowers in accordance with this Opinion shall be performed by Gulf Federal subject to periodic review by the OGC. Unless the Board orders otherwise, the OGC may not contact the affected Borrowers directly.

This Opinion constitutes the final decision of the Board in these proceedings. The Board reserves jurisdiction, however, for the purpose of taking such further action as it may deem necessary to implement its decision.

By THE FEDERAL HOME LOAN BANK BOARD

/s/ Ronald A. Snider
RONALD A. SNIDER
Assistant Secretary

Date: June 12, 1978

☆ U. S. GOVERNMENT PRINTING OFFICE: 1982 387424 314

Opposition

Office - Supreme Court, U.
FILED
APR 29 1982
ALEXANDER L. STEVA
CLERK

NO. 81-1744

In the Supreme Court of the United States

OCTOBER TERM, 1981

FEDERAL HOME LOAN BANK BOARD
Petitioner,

versus

GULF FEDERAL SAVINGS AND LOAN ASSOCIATION OF JEFFERSON PARISH
Respondent,

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

JOHN A. MMAHAT
MMAHAT, GAGLIANO, DUFFY & GIORDANO
5500 Veterans Memorial Boulevard
Metairie, Louisiana 70003
(504) 887-6962

Attorneys for Respondent,
GULF FEDERAL SAVINGS & LOAN ASSOCIATION OF JEFFERSON PARISH

A B Letter Service, Inc., 327 Chartres St., New Orleans, La. (504) 581-5555

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii
STATEMENT OF THE CASE 1
ARGUMENT 2
CONCLUSION 10

TABLE OF AUTHORITIES

Page

Statutes:

12 U.S.C.A. Section 1464(d)(2)(A) 1

Jurisprudence:

American Petroleum Institution, et al v. OSHA
581 F.2d 493 (5th Cir. 1978) 6

American Ship Building Code v. N.L.R.B.,
380 U.S. 300, 318; 85 S.Ct. 955, 967;
13 L.Ed.2d 885 (1965) 6

Barlow v. Collins,
397 U.S. 159, 90 S.Ct. 832,
225 L.Ed.2d 192 (1970) 6

Central Bank, N.A. v. Federal Home Loan Bank of San Francisco,
430 F.Supp. 1080, 1085 (N.D. Cal. 1977) 6

City Federal Savings & Loan Assn. v. FLHBB,
600 F.2d 681 (7th Cir. 1979) 6

Ernst and Ernst v. Hochfelder,
96 S.Ct. 1375, 1391; 425 U.S. 185, 213;
47 L.Ed. 668 (1976) 8

Otero Savings and Loan Association v. Federal Home Loan Bank Board,
665 F.2d 279, 291 (10th Cir. 1981) 9

West Helena Savings and Loan Association v. FHLBB,
417 F.Supp. 220, 223 (E.D. Ark. 1976) 6

STATEMENT OF THE CASE

The decision by the Court of Appeals for the Fifth Circuit (now the Eleventh) contains clear and concise reasoning and properly concludes that the powers granted by the Congress to the Federal Home Loan Bank Board under the Supervisory Act of 1966 [Sec.5(d)(2)(A) of the Home Owners Loan Act of 1933, as amended, 12 U.S.C.A. 1464(d)(2)(A)] is limited to protecting "the financial integrity of the association." The decision makes sense of the regulatory powers conferred on the Federal Home Loan Bank Board (the Bank Board) by Congress. This case does not involve management defalcations or dishonesty and the Bank Board did not find that any were present in this case. The Bank Board itself, in the hearing before the Administrative Law Judge and in its enforcement opinions, admitted that they had no problem with the management of Gulf Federal Savings and Loan Association, the respondent in this matter. [Adm. Hear., June 1, 1977, at 1/30, Petitioner's Appendix (Pet. App.) D at 95a and Pet. App. E at 141a] The court decision was proper and the writ of certiorari should be refused.

Because of the decision's clarity and the sense it makes of this regulatory area, the Bank Board should welcome this reasonable demarcation to its lines of authority. On its face Section 5(d)(2)(A) of the Home Owners Loan Act of 1933 (as amended by the Supervisory Act of 1966), 12 U.S.C.A. 1464(d)(2)(A) shows no authority granted by Congress to the Federal Home Loan Bank Board to expand

its own authority, so respondent's brief will deal only with the errors contained in the petition for the writ of certiorari. Although this petition is signed by the Solicitor General, all of the arguments were previously presented by the Bank Board and are mere rehashes of some of the arguments contained in their 130 pages of original enforcement opinions plus their briefs filed in the Court of Appeals.

ARGUMENT

On pages 6 and 17 of petitioner's brief, Footnotes 8 and 23: No borrower ever threatened a lawsuit against Gulf Federal [see 5th Cir. Decision, Petitioner's Appendix (Pet. App.) A at 4a], a brief amicus curiae was actually filed by some borrowers supporting Gulf Federal's position against the Bank Board [Pet. App. A at 17a], and there was only one borrower who even made a written complaint to the association. This was done despite the fact that this same borrower had previously been gratuitously given a reduction of the interest rate on his loan [Administrative Law Judge Decision (A.L.J. Decision) p. 7]. This reduction in interest rate was voluntarily given and was done *prior* to any complaint sent by this borrower and it was not at all connected with the issue herein. (His interest rate was reduced on May 12, 1972, and the first complaint received from this borrower was not until November 27 of that same year.) The record will also show that this borrower's withdrawal of his savings was not until June 6, 1974, after his interest rate had already been raised back up to its original rate be-

cause of a general rise in interest rates. This was also done with all the other borrowers who had been given respites by the lowering of their interest rates as rates were lowered around the country. The 24 other borrowers receiving interest rate modifications, referred to on page 6 (Footnote 8), were not connected with any action by the Federal Home Loan Bank Board and were unrelated to this action. This was simply a savings institution and its borrowers jointly helping one another in light of prevailing market conditions. While the borrowers of Gulf Federal filed a brief amicus curiae in support of Gulf Federal's position, the Federal Home Loan Bank Board could not even get any of the borrowers to come in and testify before the administrative hearing although they telephoned 37 of them and asked them to come in and testify [see Adm. Hear. June 2, 1977].

The statement of the case by the Bank Board, which starts on page 3, strays from a mere presentation of the facts. In the second paragraph on page 4, the Bank Board begins to argue its case and advocates that the statute left complete "construction and application" of the term "unsafe or unsound practice" to the financial institution regulatory agencies. However, the Fifth Circuit Court of Appeals decision made it plain that the legislative history of the statute shows that the term was not intended to be unlimited in its application [Pet. App. A at 8a].

Page 5, Number 2 in the second paragraph completely omits the fact that the Bank Board not only has no

objection to the use of the 365/360 interest table, but they expressly permit it [Pet. App. A at 2a]. On page 7 the Bank Board refers to the so-called Horne memorandum but only quotes the first part and leaves out the examples which explain the first part [see summary, Pet. App. A at 10a].

The Horne memorandum is not law but is only part of the legislative history. The examples explain the first part. They are of a limiting nature and only involve situations where there is dishonesty, self dealing and management defalcation, all of which have to be related to the "abnormal risk or loss or damage to an institution, its shareholders or the agencies administering the insurance funds." To fulfill the requirement of the definition given in the Horne memorandum, it will be as necessary for all requirements to be present. However, the Bank Board continually quotes only part of the memorandum and then begins interpreting the various words and phrases in it as if they were interpreting the statute itself instead of merely quoting part of the legislative history of the statute. This therefore would allow them to take an obscure part of the Horne memorandum, give it a unique and unusual interpretation, and Gulf Federal then would have had to not only obey the requirements of the statute itself, but also obey the terms of the memorandum and they could not do anything that would be "imprudent" in the Bank Board's opinion.

On pages 10 and 11, the Bank Board's petition fails to inform the Court that the line of cases in which the Fifth

Circuit Court of Appeals and the other Circuits have granted jurisdiction to the Bank Board have all involved wrongdoing, dishonesty, immorality and management defalcations. According to a 1977 study by the General Accounting Office, the primary cause of 30 of the 42 bank failures that occurred between 1971 and 1976 was improper, unethical and dishonest practices of bank management [see Footnote 15 on page 15 of the Bank Board's brief]. However there was nothing improper or unethical in the practice by the management of Gulf Federal Savings & Loan Association. There has been no allegation of this by the Bank Board; in fact, the admission was in the opposite direction [see Adm. Hear. June 1, 1977 at 1/30, and Pet. App. D at 95a and Pet. App. E at 141a].

The Circuit Court of Appeals correctly concluded that it had to define the heretofore undefined boundaries of the Bank Board's cease and desist authority [Pet. App. A at 8a]. Although the Bank Board thinks it was given unlimited power, every grant of power by the Congress to an Administrative Agency must have a limit to it. A grant of authority that was unlimited would be an unconstitutional delegation of congressional power. The Congress of the United States did not appoint the Federal Home Loan Bank Board as its proxy to make law at will and according to its own whim.

This points out another difference between the position of the Bank Board and the Circuit Court of Appeals'

decision and points out the differences the Bank Board has with many of the other circuits.

The Bank Board claims that its interpretation of the statute is entitled to great deference. However, because this is a favorite ploy used by the regulatory agencies to expand their own power, the courts have insisted that it takes judicial expertise rather than administrative expertise to interpret statutes. See *Central Bank, N.A. v. Federal Home Loan Bank of San Francisco*, 430 F.Supp. 1080, 1085 (N.D. Cal. 1977), quoting *Barlow v. Collins*, 397 U.S. 159, 90 S.Ct. 832, 225 L.Ed.2d 192 (1970) and *American Ship Building Code v. N.L.R.B.*, 380 U.S. 300, 318; 85 S.Ct. 955, 967; 13 L.Ed.2d 885 (1965); *West Helena Savings and Loan Association v. FHLBB*, 417 F.Supp. 220, 223 (E.D. Ark. 1976); *City Federal Savings and Loan v. FHLBB*, 600 F.2d 681 (7th Cir. 1979); *American Petroleum Institution, et al v. OSHA*, 581 F.2d493, 497 (5th Cir. 1978).

Although the agencies quote it to cover all their expansionist actions, the so-called deference to administrative expertise does not apply here. The Fifth Circuit decision held that "Defining the limits of such powers requires judicial, not administrative, expertise." They then concluded that, "For this reason, the Board's call for deference to agency expertise is misplaced." [Pet. App. A at 8a]

On page 11 the Bank Board accuses the Circuit Court of Appeals of imposing ". . . artificial restrictions on

the broad statutory language. . . [of the act]." Firstly, the petition completely ignores the Court's exhausted analysis of the entire legislative history of the Supervisory Act of 1966 and ignores the second part of the Horne memorandum. The Fifth Circuit concluded ". . . even if the Board's premise is correct, the legislative history of the section belies its conclusion. . .".

Secondly, the Bank Board does not dispute any of the court's interpretation of the legislative history of the act, nor of the court's conclusion of the act's purpose as set out in the Horne memorandum *and* in the examples listed therein. But while the Court held that the power given to the Board is limited to protecting ". . . an association's financial condition" [Pet. App. A at 11a], the Bank Board contends that it should be the agency that decides whether "an association's financial condition" is at stake or not.

The circumstances of the present case clearly show that the association's financial condition is not at stake but, on the contrary, it is the Bank Board's protectice measures which make ". . . definite and immediate an injury which is, at worst, contingent and remote." [id] The Bank Board, however, continues to argue that it should be the final authority which should decide what is best for an association's financial condition, because "in their opinion" the cease and desist order would give rise to long term benefits which would some day possibly make the association's financial condition better.

The Circuit Court held that the dangers and "risks", cited by the Bank Board, ". . . bear only the most remote relationship to Gulf Federal's financial integrity and the government's insurance risk" [Pet. App. A at 10a]. These risks, the Court held, ". . . are qualitatively different from the risks Chairman Horne called to the attention of the 89th Congress" [id]. This then is a key question to which the Petition for Writ should be addressing itself. However, the petition ignores this question and there is one simple reason and that is there is a difference and the Bank Board knows it. Since they are unable to produce any logical explanation; they just choose to ignore the question. In the absence of putting this into issue, there is no reason whatsoever to grant the writ.

Even though the Administrative Agencies were told by this Court very clearly in the case of *Ernst and Ernst v. Hochfelder* [96 S.Ct. 1375, 1391; 425 U.S. 185, 213; 47 L.Ed. 668 (1976)], that "The rule-making power granted to an administrative agency charged with the administration of a federal statute is not the power to make law", the Bank Board is trying to expand its own authority without the aid of Congress and is telling the judicial system not to second guess them.

The Bank Board argues on Page 12: "The Agencies' supervisory powers are currently exercised almost entirely by conciliation and agreement", and if they can't give themselves this power it will curtail that ability. This fails

to recognize that conciliatory ability is based on mutual respect and confidence. To allow the Bank Board to give itself new authority not intended by Congress will not promote mutual confidence and respect but will, in fact, communicate to the savings and loan industry that the Bank Board is arbitrary, dictatorial and regulates by whim. This condition is what will cause dissension and encourage litigation. It will be highly beneficial to the regulatory process for associations to know in advance what they are or are not able to do as free business enterprises. They will be able to conduct business without interference from Administrative Agencies, including the Bank Board, as long as they are obeying the promulgated rules, not harming the "financial integrity" of the institution, or not engaging in dishonest acts or management defalcations. For the greater good of the industry, all cease and desist orders that are not properly issued by the Bank Board, or involve areas the Bank Board is not permitted by Congress to go into, should be resisted. This is still a government of laws and not of regulatory agencies. The results in the instant case confirm this and so does the concurring opinion in *Otero Savings and Loan Assocation v. Federal Home Loan Bank Board* [665 F.2d 279, 291 (10th Cir. 1981)].

In light of the severe economic difficulties currently facing the savings and loan industry, it is important that all savings and loan associations be allowed to conduct their business independently and to recover financially without the Bank Board interfering. It is tragic that an association should have to fear entering an area of profit-

ability which could help them out of the dire present financial consequences facing the savings and loan industry because they fear that maybe this area of profitability might meet with the Bank Board's displeasure at some later date and they would have to give the profits they made back. This would be so even though other private industries, such as privately owned loan companies unencumbent by the handicap of being in the Bank Board's grip, are allowed to make profit from this same area.

CONCLUSION

The Petition for a Writ of Certiorari should be denied and the decision of the Court of Appeals for the Fifth (now the Eleventh) Circuit should stand.

Respectfully submitted,

John A. Mmahat
MMAHAT, GAGLIANO, DUFFY
& GIORDANO
5500 Veterans Memorial Boulevard
Metairie, Louisiana 70003